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Into the storm

What will happen to the emerging economies?



Print edition October 25th 2008

Into the storm

How the emerging world copes with the tempest will affect the world economy and politics for a long time: leader



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Nigeria's president
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Europe

Nicolas Sarkozy
The president who loved summits

France's finance minister
On Lagarde

Spain and the civil war
Ghost story

East Germany's past
The history boys

Italian immigration
When Brussels trumps Rome

Turkey's economy
In need of an anchor

Charlemagne
Preparing for a new president

Britain

The politics of a shrinking economy
End of the phoney peace

Equality
Pain all round, please

Graduate recruitment
What next?

Literary legacies
An uncommon gift

Abortion in Northern Ireland
No change

Migration
Coming or going?

Pension problems
Model at risk

Bagehot
The king of Corfu

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International

The anti-West
An axis in need of oiling

Endangered languages
When nobody understands

Catholics and Jews
The weight of history

"Things Fall Apart"
A golden jubilee

Alex the African Grey
My parrot and I

AIDS in India
Sex and the poor

"Byzantium"
Domes of gold

Obituary

Ted Briggs

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

The Economist commodity-price index

Trade, exchange rates, budget balances and interest rates

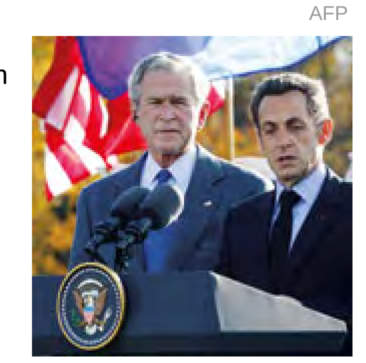
Markets

Total tax revenue

Politics this week

Oct 23rd 2008
From The Economist print edition

AFP



George Bush held a meeting at Camp David to discuss the **global financial crisis** with Nicolas Sarkozy, the French president, who is also the current head of the European Union, and José Manuel Barroso, the president of the European Commission. Later, a date of November 15th was set for a summit in Washington of 20 countries, including such emerging economies as China, India, Russia and South Korea. The summit will address a "common set of principles" for reforming the regulation of international markets. Broadly speaking, the Europeans want more of it, but the Americans are resisting.

In a speech to the European Parliament in Strasbourg Mr Sarkozy suggested that governments should take shareholdings in big companies and that Europe should set up the equivalent of **sovereign-wealth funds** to deter foreign predators. See article

Ben Bernanke threw his support behind a new $150 billion **stimulus package** that the Democrats want to pass. The chairman of the Federal Reserve said the measure "seemed appropriate" given the outlook for a protracted economic slowdown. See article

Barack Obama received a big boost with an endorsement from **Colin Powell**. Mr Bush's first secretary of state described the Democrat as a "transformational figure" who would "electrify" America and the world. Mr Obama held out the possibility of offering Mr Powell a formal position in his administration, should he win. See article

Amid the financial crisis and economic woes it emerged that the Republican Party spent some $150,000 on "campaign accessories" for **Sarah Palin** in September. The party went on a shopping spree at stores such as Neiman Marcus and Barneys to kit out the self-styled hockey mom.

Early-polling booths opened across **Florida**. Election officials reported a steady turnout of voters eager to avoid long queues on November 4th.

Down to earth

China's Communist Party revealed details of reforms intended to make it easier for farmers to transfer land and consolidate landholdings. But the reform stopped short of changing the "collective" ownership of rural land or allowing farmers to mortgage their land and houses.

EPA

India successfully launched its first **mission to the moon**. An unmanned spacecraft will undertake a two-year exploration in orbit around the moon, mapping the distribution of minerals and elements.

The IMF reported that **Pakistan** had asked it for help to cope with a balance-of-payments crisis. This followed the apparent failure of efforts to raise bilateral loans from America, China and Saudi Arabia. See article

A route across the line of control separating Indian- and Pakistani-controlled **Kashmir** was opened to lorry traffic for the first time in 60 years.

Thailand's Supreme Court found Thaksin Shinawatra, a former prime minister currently in Britain, guilty of corruption and sentenced him to two years in prison. Protests continued in Bangkok against the present government, led by Mr Thaksin's brother-in-law, Somchai Wongsawat. See article

The police in **Indonesia** said they had arrested five members of a militant Islamist cell who were planning to blow up an oil depot in Jakarta.

Jacob's ladder

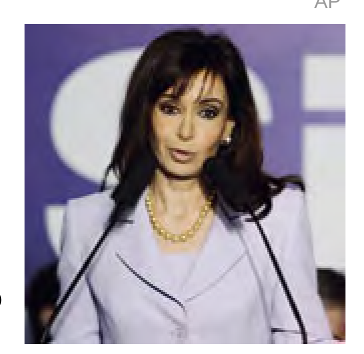
In **South Africa** the judge who dismissed a corruption case against Jacob Zuma, the leader of the ruling African National Congress, said that prosecutors could appeal against the ruling. If the case is reopened, it could hamstring Mr Zuma in his expected bid to become president next year.

A draft of a Status of Forces Agreement between **Iraq** and the United States (which provides for American forces to stay in Iraq after a UN mandate expires at the end of this year) set a date of American troop withdrawals by the end of 2011. But it was still not clear whether this was a final agreement or whether Iraq's parliament would endorse the deal. See article

Under the aegis of Egyptian mediators, the opposing **Palestinian** factions, Fatah and Hamas, said they would meet in Cairo on November 9th in a bid to end their fratricidal differences.

Social insecurity

AP



Argentina's president, Cristina Fernández de Kirchner, announced a bill to nationalise private pension funds set up in the 1990s. She said this was to protect retirees from the market turmoil. Opponents and investors reckoned it was a prelude to a government raid on the pension system to stave off a debt default. The price of Argentine shares and bonds plummeted. See article

Bolivia's Congress approved the new constitution sought by Evo Morales, the socialist president, which will be put to a referendum in January. The government agreed to changes in the text, to expand regional autonomy and to restrict Mr Morales to one more term. The revisions followed violent opposition protests and mediation by the Union of South American Nations, a new regional body.

Stéphane Dion said he would step down as leader of **Canada's** opposition Liberal Party at a leadership convention next spring. Mr Dion led the party to its lowest-ever share of the vote at this month's general election.

Georgian building

Western aid donors pledged to give $4.5 billion to **Georgia** to help the costs of rebuilding after the war with Russia. Russia was not invited to the pledging conference.

Spain's attorney-general appealed to a higher court against an indictment brought by an activist magistrate, Baltasar Garzón, against General Franco and 34 of his henchmen for crimes against humanity. All the targets of Mr Garzón's case are dead. See article

A controversial trial of 86 people in **Turkey** opened near Istanbul. The so-called "Ergenekon group", which includes former army officers, is charged with plotting attacks to provoke a military coup.

A senior **British** Tory, George Osborne, rejected claims that he had sought a party donation from a Russian oligarch, Oleg Deripaska, while visiting Mr Deripaska's yacht on holiday in Corfu. Also on the same holiday was Labour's Peter (now Lord) Mandelson. Mr Osborne had caused upset by allegedly leaking disrespectful statements made by Mr Mandelson about the Labour leader, Gordon Brown. See article

Business this week

Oct 23rd 2008
From The Economist print edition

America's Federal Reserve took further measures to boost liquidity by unveiling a plan to provide up to $540 billion to support **money-market mutual funds**. The funds, which are usually low-risk investments in short-term debt, have been troubled since the collapse of Lehman Brothers, which caused Reserve Primary to lose money for its investors, the first time such a fund had done so for 14 years. Around $500 billion has since been withdrawn from the market, which invests in commercial paper, certificates of deposit and other financial instruments. The Fed's facility creates five "special-purpose vehicles" that will buy instruments held by the funds.

Wachovia reported a $23.7 billion quarterly loss, the biggest ever for an American bank. The company wrote down $18.7 billion in goodwill, partly because of declining asset values. The takeover of Wachovia by Wells Fargo is proceeding as planned.

Seeking public support

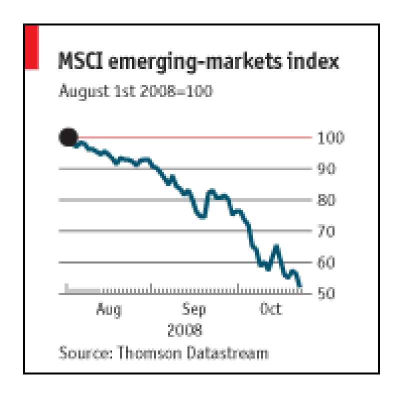
European banks began tapping the rescue funds offered recently by their governments. **BayernLB** sought €5.4 billion ($7.2 billion) in aid, the first German bank to do so, and France provided €10.5 billion to six banks, with half the total going to **Crédit Agricole** and **BNPParibas**. Meanwhile **Sweden** detailed a broad bail-out programme for its banking sector, which could involve up to SKr1.5 trillion ($200 billion).

ING received a €10 billion ($13 billion) lifeline. ING's retail-deposit base was thought to be large enough to prevent it from having to recapitalise, but its share price sank after it said it expected to make its first-ever quarterly loss, forcing it to turn to the Dutch government.

There were signs that the concerted effort by central banks to improve liquidity was thawing the money markets, and that banks were beginning to lend to each other again. **Interbank loan rates** continued to fall, in some cases to the levels they were at in mid-September. See article

The **pound** dropped to a five-year low against the **dollar**, $1.63, when Mervyn King, the governor of the Bank of England, issued his most downbeat assessment yet of the **British economy**, asserting that it was now "entering a recession". The **euro** fell to a two-year low against the dollar on speculation that the European Central Bank would cut interest rates further. See article

No safe harbour



Stockmarkets endured another rocky week. However, investors in **emerging markets** were unnerved by the unfolding pensions situation in Argentina (which hurt share prices throughout Latin America), the news that borrowing costs for developing countries were at a five-year high, and economic woes in Hungary, South Korea and Ukraine. See article

China's GDP growth rate slowed to 9% in the third quarter, year-on-year, its lowest for five years. See article

The share price of **CITIC Pacific**, part of China's largest state-owned investment group, plunged by 55% after it said it could lose up to $2 billion after betting that the Australian dollar would strengthen. The currency has fallen by 15% this month against the American dollar, which has grown robust since the start of the financial crisis. CITIC's revelation comes soon after **Caisse d'Epargne**, a French bank, said a "trading mistake" had cost it €600m ($808m).

Exiting Detroit

Kirk Kerkorian decided to start cutting his loses at **Ford**. In April the investor revealed that he had built up a stake in the carmaker—reaching 6.4%—which was taken as affirmation that Ford's turnaround strategy was working. Since then, its share price has tumbled. Mr Kerkorian is now offloading his stock, and he could stand to lose $700m. See article

Exelon, one of America's largest electricity companies, launched a $6.2 billion unsolicited offer for **NRGEnergy**, which operates power plants in southern California, Texas and the north-east. The financial turmoil has caused the share prices of some debt-burdened energy companies to tumble, and analysts expect more consolidation in the industry. Exelon said its deal would create the largest power company in the United States.

Samsung Electronics withdrew its $5.9 billion offer to buy **SanDisk**, citing the shrinking earnings potential at the Californian company, which produces flash-memory technology used in digital cameras, music players and the like.

Yahoo! said it would cut 10% of its workforce by the end of the year amid a weakening market for online advertising. See article

Apple cheered investors when it said quarterly net profit was up by 26% compared with a year ago on the back of strong iPhone sales—it shifted almost 6.9m in the quarter. However, the company issued a cautious outlook for the rest of the year.

KAL's cartoon

Oct 23rd 2008
From The Economist print edition

Illustration by KAL



Into the storm

Oct 23rd 2008
From The Economist print edition

How the emerging world copes with the tempest will affect the world economy and politics for a long time



FOR much of the past year the fast-growing economies of the emerging world watched the Western financial hurricane from afar. Their own banks held few of the mortgage-based assets that undid the rich world's financial firms. Commodity exporters were thriving, thanks to high prices for raw materials. China's economic juggernaut powered on. And, from Budapest to Brasília, an abundance of credit fuelled domestic demand. Even as talk mounted of the rich world suffering its worst financial collapse since the Depression, emerging economies seemed a long way from the centre of the storm.

No longer. As foreign capital has fled and confidence evaporated, the emerging world's stockmarkets have plunged (in some cases losing half their value) and currencies tumbled. The seizure in the credit market caused havoc, as foreign banks abruptly stopped lending and stepped back from even the most basic banking services, including trade credits.

Like their rich-world counterparts, governments are battling to limit the damage (see article). That is easiest for those with large foreign-exchange reserves. Russia is spending $220 billion to shore up its financial services industry. South Korea has guaranteed $100 billion of its banks' debt. Less well-endowed countries are asking for help. Hungary has secured a €5 billion ($6.6 billion) lifeline from the European Central Bank and is negotiating a loan from the IMF, as is Ukraine. Close to a dozen countries are talking to the fund about financial help.

Those with long-standing problems are being driven to desperate measures. Argentina is nationalising its private pension funds, seemingly to stave off default (see article). But even stalwarts are looking weaker. Figures released this week showed that China's growth slowed to 9% in the year to the third quarter—still a rapid pace but a lot slower than the double-digit rates of recent years.

Blowing cold on credit

The various emerging economies are in different states of readiness, but the cumulative impact of all this will be enormous. Most obviously, how these countries fare will determine whether the world economy faces a mild recession or something nastier. Emerging economies accounted for around three-quarters of global growth over the past 18 months. But their economic fate will also have political consequences.

In many places—eastern Europe is one example (see article)—financial turmoil is hitting weak governments. But even strong regimes could suffer. Some experts think that China needs growth of 7% a year to contain social unrest. More generally, the coming strife will shape the debate about the integration of the world economy. Unlike many previous emerging-market crises, today's mess spread from the rich world, largely thanks to increasingly integrated capital markets. If emerging economies collapse—either into a currency crisis or a sharp recession—there will be yet more questioning of the wisdom of globalised finance.

Fortunately, the picture is not universally dire. All emerging economies will slow. Some will surely face deep recessions. But many are facing the present danger in stronger shape than ever before, armed with large reserves, flexible currencies and strong budgets. Good policy—both at home and in the rich world—can yet avoid a catastrophe.

One reason for hope is that the direct economic fallout from the rich world's disaster is manageable. Falling demand in America and Europe hurts exports, particularly in Asia and Mexico. Commodity prices have fallen: oil is down nearly 60% from its peak and many crops and metals have done worse. That has a mixed effect. Although it hurts commodity-exporters from Russia to South America, it helps commodity importers in Asia and reduces inflation fears everywhere. Countries like Venezuela that have been run badly are vulnerable (see article), but given the scale of the past boom, the commodity bust so far seems unlikely to cause widespread crises.

The more dangerous shock is financial. Wealth is being squeezed as asset prices decline. China's house prices, for instance, have started falling (see article). This will dampen domestic confidence, even though consumers are much less indebted than they are in the rich world. Elsewhere, the sudden dearth of foreign-bank lending and the flight of hedge funds and other investors from bond markets has slammed the brakes on credit growth. And just as booming credit once underpinned strong domestic spending, so tighter credit will mean slower growth.

Again, the impact will differ by country. Thanks to huge current-account surpluses in China and the oil-exporters in the Gulf, emerging economies as a group still send capital to the rich world. But over 80 have deficits of more than 5% of GDP. Most of these are poor countries that live off foreign aid; but some larger ones rely on private capital. For the likes of Turkey and South Africa a sudden slowing in foreign financing would force a dramatic adjustment. A particular worry is eastern Europe, where many countries have double-digit deficits. In addition, even some countries with surpluses, such as Russia, have banks that have grown accustomed to easy foreign lending because of the integration of global finance. The rich world's bank bail-outs may limit the squeeze, but the flow of capital to the emerging world will slow. The Institute of International Finance, a bankers' group, expects a 30% decline in net flows of private capital from last year.

A wing and a prayer

This credit crunch will be grim, but most emerging markets can avoid catastrophe. The biggest ones are in relatively good shape. The more vulnerable ones can (and should) be helped.

Among the giants, China is in a league of its own, with a $2 trillion arsenal of reserves, a current-account surplus, little connection to foreign banks and a budget surplus that offers lots of room to boost spending. Since the country's leaders have made clear that they will do whatever it takes to cushion growth, China's economy is likely to slow—perhaps to 8%—but not collapse. Although that is not enough to save the world economy, such growth in China would put a floor under commodity prices and help other countries in the emerging world.

The other large economies will be harder hit, but should be able to weather the storm. India has a big budget deficit and many Brazilian firms have a large foreign-currency exposure. But Brazil's economy is diversified and both countries have plenty of reserves to smooth the shift to slower growth. With $550 billion of reserves, Russia ought to be able to stop a run on the rouble. In the short-term at least, the most vulnerable countries are all smaller ones.

There will be pain as tighter credit forces adjustments. But sensible, speedy international assistance would make a big difference. Several emerging countries have asked America's Federal Reserve for liquidity support; some hope that China will bail them out. A better route is surely the IMF, which has huge expertise and some $250 billion to lend. Sadly, borrowing from the fund carries a stigma. That needs to change. The IMF should develop quicker, more flexible financial instruments and minimise the

conditions it attaches to loans. Over the past month deft policymaking saw off calamity in the rich world. Now it is time for something similar in the emerging world.





Land reform in China

Still not to the tiller

Oct 23rd 2008
From The Economist print edition

A timid approach to an issue of burning concern to one-eighth of the world's people



AGAINST the ear-piercing screech of the global economy hitting the brakes, what sounded like a piece of good news could still be heard this week. China's Communist Party unveiled its plan to double, by 2020, the disposable income of the 750m people in the Chinese countryside. One way it hopes to achieve this is through land reform. The party's propagandists hailed this as a "landmark" decision, even drawing parallels with an event for which 30th anniversary celebrations loom: the launch of China's reforms, with Deng Xiaoping's rise to political ascendancy in December 1978. Sadly, there is less to the new reform than meets the eye. As so often with long-awaited party pronouncements, much of the "breakthrough" is already common practice and the toughest issues are skirted. The actual reform is rather minor.

At least, however, it is aimed at the right target: the obstacles preventing farmers from exchanging their land, and building bigger, more economic, landholdings by consolidating the "noodle strips" of family plots they have held since the break-up of the old rural communes. These obstacles have indeed suppressed productivity, incomes and social mobility in the countryside, and contributed to the widening gap between town and country. Removing them would be a huge boost to China's economy. Introducing a proper market in agricultural land would also do much to reduce one of the main sources of social tension in China: land-grabs by local authorities for which peasants are often poorly compensated, if at all. Every year, there are tens of thousands of protests across China by the disgruntled dispossessed.

China's cities have set the example. There the housing market has been in effect privatised for a decade. Land is state-owned but easily traded on long leases. The resulting boom in home-ownership has been a huge factor in the emergence of a prosperous middle class—now grappling with the unfamiliar horrors of a falling market (see article).

The new plan promises something similar in the countryside. It allows farmers "to lease their contracted farmland or transfer their land-use rights". Since decollectivisation and the introduction of Deng's "household-contract responsibility system", rural land has been held by individual families. But it has remained "collectively" owned. Farmers have been granted 30-year leases, or land-use rights, which the party is now promising to make easier to transfer. That, however, is already allowed by law and has been happening for years.

The "new" proposals are not explicit on this, but a senior official has since suggested that leases may be made longer than 30 years. Yet the shortness of most peasants' contracts—if they are lucky enough to live in places where local officials have got around to handing them out—is only one part of the problem. The party does not propose lifting the legal ban on farmers' mortgaging their land and houses. So it will remain difficult for them to raise money to up sticks. Nor does it tackle the biggest issue: "collective"

ownership, which the party decrees must not change. This may be partly for fear of making a near-reality of private landownership, which would undermine one of the last vestiges of the party's communist heritage.

What collective means in theory is rather woolly; in practice, much less so. It often refers to a bunch of party-approved village apparatchiks arrogating ownership rights for themselves. It is their stitching up of deals, pocketing of kickbacks and fleecing of farmers that provokes so many protests. Besides safeguarding their interests, the latest plan also preserves strict limits on the transfer of arable land. To preserve "food security", China has set a minimum area for the country's farmland—120m hectares, just below the present level.

Something old, something new

It is on the non-arable "construction" land that the latest policy offers something new. It extends an experiment tried in Guangdong province, allowing such land to be traded without first going through government acquisition. In practice, of course, farmers will still be hostage to the whims of the collective and its often ugly human faces. Only a far more fundamental political reform would solve that problem: defining collective more precisely and opening the top job in the village, the party secretaryship, to genuinely competitive elections, ideally including non-party candidates.

It is a shame that such a reform is not on the cards; and that, even without it, the party's approach to land reform is so timid. But, recalling those epochal reforms of 30 years ago, it is worth remembering that they too tended to come in baby steps rather than great leaps, and often were formulated retrospectively. In tiptoeing gingerly around one of the last Maoist shibboleths—collective landownership—the party may yet be sowing the seeds of the rural transformation it promises.




Information technology

Clouds and judgment

Oct 23rd 2008
From The Economist print edition

Computing is about to face a trade-off between sovereignty and efficiency

Illustration by David Simonds



WORRYING about the next big thing in high-tech may seem otherworldly just now. The world is flirting with recession and IT is likely to suffer badly as a result (see article). Yet this will not stop a shift that promises to affect everyone (see our special report this week). Computing is fast becoming a “cloud”—a collection of disembodied services accessible from anywhere and detached from the underlying hardware. The chances are that much of business and everyday computing will one day be mediated by this ethereal cloud.

This presents a paradox. On one hand, computing will be a borderless utility. Technically, it need not matter whether your data and programs are stored down the road or on the other side of the world; everything will look as if it is happening on the screen in front of you. On the other, geography still matters. The data centres that contain the cloud, each often the size of several football pitches, cannot be built just anywhere. They need cheap power, fibre-optic cables, a chilly climate and dry air (otherwise you have to remove heat and humidity, which do horrible things to electronics). Good sites are scarce. Iceland fits the bill. Google is even thinking of building floating data centres, cooled by seawater and powered by the waves.

The legal and political issues are thornier. Even more than previous cross-border utilities, such as the telephone and the internet, the cloud will be a cosmopolitan prisoner to laws that are mainly local. Personal information will be nowhere and everywhere, but most privacy laws still assume that data resides in one place. It is the same with obscenity, hate crime and libel. And online crooks can easily jump from one jurisdiction to another, whereas the authorities from different countries have yet to learn how to co-operate.

The danger is less that the cloud will be a Wild West than that it will be peopled by too many sheriffs scrapping over the rules. Some enforcers are already stirring up trouble, threatening employees of online companies in one jurisdiction to get their employers based in another to fork over incriminating data for instance. Several governments have passed new laws forcing online firms to retain more data. At some point, cloud providers may find themselves compelled to build data centres in every country where they do business.

There is a balance to be struck here between sovereignty and efficiency. If democracies decide to ban certain types of speech or to protect their citizens’ data, they must be able to enforce their rules. Yet at the same time, the more the cloud is lassoed with regulation, the more its costs will grow. That would be a loss. The cloud’s main promise is to make computing cheaper using huge economies of scale. Such savings promise to help countless smaller firms in developing countries, say, to benefit from IT and the

productivity gains it creates.

The dearth of distance

It will not be easy to strike the balance, but at the very least governments can enhance efficiency without threatening their own sovereignty. Countries could sign up to a global minimum standard in areas such as privacy. Law-enforcement agencies from different countries could foster the habit of co-operation. Governments need to be sure that standards are not just an underhand way of keeping the data business within their own borders. Even then, some national differences are bound to endure, so cloud-computing services will have to take place on systems designed to cope. For instance, Microsoft, which is building a global computing platform, is designing a system that can accommodate some regulation, such as keeping data within national borders. The cloud may be global, but the climate will sometimes be local.

Iraq

When to call the soldiers home

Oct 23rd 2008
From The Economist print edition

Why it is in America's own interest to let the Iraqis have their way

AFP



BARACK OBAMA and John McCain have spent much of the past year quarrelling about when and how the United States should leave Iraq, hoping to sway the minds of millions of American voters. What is sometimes overlooked in this quarrel is that Iraq has rather an important vote too.

The Bush administration and the Iraqi government have been having a tetchy negotiation in recent months about how long, and under what terms, American forces will be allowed to stay after their United Nations' mandate expires at the end of December. Since Iraq's prime minister, Nuri al-Maliki, knows he needs the help of American forces a good while longer, and the Americans know that he knows, the likelihood is that the two sides will come to an agreement. But the talks have gone on longer than expected, so a breakdown is not impossible. That could have very bad consequences.

The gap is not huge. The latest leaked draft would "aspire" to have American troops leaving Iraq by the end of 2011. That is later than Mr Obama's preferred date (May 2010) and probably earlier than Mr McCain's (unspecified), but the date itself is not as big an issue as it seems. Both candidates have left themselves room for manoeuvre, and Mr Maliki probably wants flexibility too, in case he still needs American firepower three years hence to suppress insurgents or defend his borders.

The trouble is that Mr Maliki is not Saddam Hussein. For all the things America has got wrong in Iraq, the government in Baghdad is not the dictatorship or the theocracy that critics once saw as the only possible outcomes of this bungled war. Instead, Iraq is beginning to resemble a democracy, albeit a fragile and imperfect one. Mr Maliki, running a small party in an unruly coalition, has both provincial and parliamentary elections ahead. So whatever his private views, he needs to take account of the impatience of Iraqis to see the back of the occupiers. He also needs to be seen to drive a hard bargain.

A time to play the long game

And America's interest, strange as it sounds, is to let him do just that. Having booted out the previous regime, the American army is apt to feel it can do what it likes in Iraq, especially when it comes to the conduct and deployment of its own troops. No longer. If it is to secure its long-term relationship with Iraq, the superpower had better adjust fast to the idea that Iraq is once again a sovereign country, one that has a powerful sense of wounded pride and some prickly sensibilities.

By some accounts, the Americans have already conceded a lot. They are reported, for example, to have promised that military operations in Iraq will be more closely co-ordinated with the Iraqi government,

that American troops will leave the streets, and, perhaps, that soldiers who commit crimes while not in their bases or on operations could be subject to Iraqi law. Some of these undertakings stick in the craw of an army with an understandable instinct for control freakery. The last is especially tricky, given Iraq's dysfunctional justice system. But they are a small price to pay to secure the gains for which American soldiers in Iraq have paid with so much blood.

And that is what's at stake. Look ahead: within a few years, most of the troops will be out and America will depend on soft power to compete with Iran for the hearts and minds of Iraqis. Pro-Iranian parties in Iraq already portray the troop talks as a bid to turn Iraq into an American vassal. Mr Maliki must find the courage to explain in public why this is not so. But by doing more to help him, perhaps by supporting that "aspiration" for 2011 a bit more enthusiastically, America's departing president could leave the next one a far better chance of keeping Iraq on America's side in the years to come.

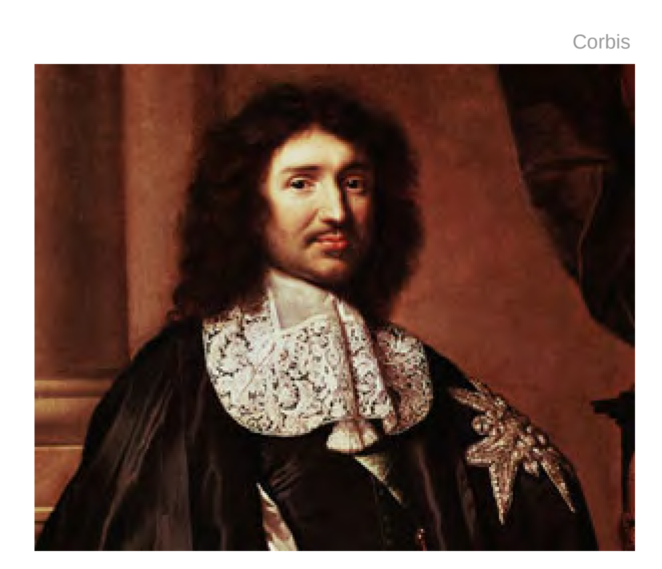
 

Re-bonjour, Monsieur Colbert

Oct 23rd 2008
From The Economist print edition

To paraphrase George Bush, what's the French for "dirigiste"?

Corbis



THIS summer, when Jim Bunning, a senator from Kentucky, read in his morning paper that the American government had taken control of Fannie Mae and Freddie Mac, he thought he had "woken up in France". In the weeks since, Western governments have spent hundreds of billions of dollars buying up the banking system. America's government has given its carmakers $25 billion in soft loans. And Nicolas Sarkozy, France's president, has floated the idea of a group of European sovereign-wealth funds taking stakes in the continent's most important firms (see article).

Much fuss has been made about the return of John Maynard Keynes. But the ghost jumping triumphantly from his grave is a French bureaucrat, not a British economist. Jean-Baptiste Colbert brought industrial policy to the court of Louis XIV, rebuilding the economy around national champions.

Now suddenly every politician has ideas about how to run a business. Thus Congressman Henry Waxman (no doubt inspired by the picture of Colbert that hangs in the House of Representatives) lambasted the rescued American International Group for spending $440,000 on a junket for a crew of life-insurance agents (no matter that the reps were self-employed). Britain's Tories want to stop bonuses in the banks their government has just bought (clever idea: driving away good staff just when you need them). Politicians everywhere want banks to be free with their credit (not normally the route to profits).

What a bunch of amateurs. If the new *dirigistes* seriously want to find out how to use their new toys, they should all go to France. With three rounds of nationalisation, in 1936, 1945-46 and 1981, business has long been the business of the French state. Two-thirds of the country's 20 biggest companies have had experience of state ownership. Here surely is a blueprint.

Sadly the main lesson from modern Colbertism is simple: return companies to the private sector as quickly as possible. A few utility-like industries, such as nuclear power and high-speed trains, have certainly benefited from "the planners' vision". Mr Sarkozy is also proud of the state's rescue of Alstom, an engineering giant, in 2003. But most went the other way. Groupe Bull turned out to be an apter name for France's answer to IBM than could ever have been intended. And banks seem especially vulnerable to dreams of glory. Inspired by Jean-François Hénin, the "Mozart of finance", Crédit Lyonnais set out to be the banking champion of Europe. In 1991 it even took over MGM studios (would you go to a film made by a bank, even a French one?). The state's use as a shareholder in the bank, a government inquiry found, had been "close to nil".

Hissing, but not many feathers

The collapse of Crédit Lyonnais was embarrassingly public. Other costs of state ownership are harder to spot. Putting civil servants with no experience of business at the top of large companies was mostly a disaster. In some groups, several ministries would each appoint board directors, prompting turf battles. And protecting old champions hindered the emergence of new ones. Of the largest 25 listed French companies, none was founded in the past 50 years; at least five of America's biggest ones have yet to reach their half-century.

France has been unwinding state ownership for the past two decades. In 2003 the then finance minister, Francis Mer, set up an agency to professionalise the government's shareholdings. Interestingly, the reforming Mr Mer had ended up in politics after a long career in business. Colbert may well be back; but he is not the solution.

On the European Union, Stephen Harper, religion, health care, fair-value accounting, organ donations, Cuban-Americans, Russia, the state

Oct 23rd 2008
From The Economist print edition

Changing the rules

SIR – In trying to explain just how the European Union managed to fail to respond in an orderly and efficient manner to the recent financial crisis, you relied on a classic but ultimately soft explanation: it "had less to do with institutional architecture than with political will" ("The European Union's week from hell", October 11th). To be sure, political will, or better the lack thereof, is playing a part in Europe's present economic and financial turmoil, but only of a second order. The European predicament is much more serious than that.

As all financial hell breaks loose and recession looms large, the EU is stuck with tax- competition policies, a slow-motion monetary regime and holier-than-thou fiscal-policy rules. As the economists James Buchanan and Geoffrey Brennan once put it, good games depend on good rules more than they depend on good players. The same, it must be said, goes for bad games. If the bell tolls for the American framework for growth, it rings louder for the European model of governance.

Éloi Laurent
Senior economist
OFCE (Sciences Po Centre for Economic Research)
Paris

Harpooning Harper

SIR – *The Economist*'s endorsement of Stephen Harper in Canada's general election lacked both evidence and logic ("The fear factor", October 11th). Mr Harper is not the pillar of governmental stability that you imagine him to be, nor is he a bulwark against "panic". If panic serves his purposes he will rattle the bars and sound the klaxon, as he has done on the issue of "crime in the streets". He is not bad at targeting unpopular minorities too—witness his caricature of Canada's artists and chattering intellectuals. His foreign policy is a dull and witless imitation of George Bush's, and he has imported the Republican strategy of mendacious name-calling in lieu of rational argument. This is not the model of prudent management you depict.

Robert Bothwell
Director
International Relations Programme
University of Toronto
Toronto

A religious phrase

SIR – You always bandy about the phrase "mildly Islamist" in articles on Indonesia and Turkey; indeed, you seem incapable of writing "Islamist" in any context other than suicidal fanaticism without putting "mildly" in front of it ("The lady is for returning", September 27th). Religion is not mild. It is a deep and abiding belief in the righteousness of one's personal God that when unconstrained in government translates into correspondingly uncompromising legislation. The ransacked mosques in Jakarta of Ahmadiyah, a moderate Muslim sect, and the dwindling Christian populations of eastern Turkey are witness to the effects of even "mildly" dogmatic policy.

It is not the charters of religious parties that preserve the freedoms of non-believers in Indonesia and

Turkey, but the safeguard institutions of, respectively, *pancasila* and the secular military, without which your favourite adverb would be mildly inaccurate.

Drew Newman
Jakarta

Freedom to choose

SIR – The Massachusetts system of "universal" health care remains afloat only because of hundreds of millions of dollars in federal support ("In need of desperate remedies", October 18th). One reason costs are so high in Massachusetts is that individuals are forced to purchase benefits they neither need nor want. Under any system of mandatory insurance, the state must necessarily define what constitutes an acceptable insurance policy, meaning that individuals are buying insurance on terms influenced by lobbyists and bureaucrats, rather than based on a rational assessment of their needs. If the federal government adopts the Massachusetts system on a national scale, it would merely multiply those problems fifty-fold.

Dr Paul Hsieh
Co-founder Freedom and Individual Rights in Medicine
Sedalia, Colorado

Current estimates

SIR – Those debating fair-value accounting are in danger of shooting the messenger ("Fair cop", October 4th). If a prospective house buyer were asked the question: "What would be the more meaningful information—the best estimate of the market value of the property you are considering buying today, the best estimate last year, or some sort of hybrid number?", few would disagree with the answer, no matter how painful economic reality may feel to the seller.

While fair-value accounting for financial instruments may not be perfect, its suspension would diminish transparency at a time when investors badly need less opacity, not more.

Michael Izza
Chief executive
Institute of Chartered Accountants in England and Wales
London

Easing a difficult decision

SIR – I read your article on organ transplants with interest ("The gap between supply and demand", October 11th). I am the father of a seven-year-old boy, Nicholas Green, who was shot and killed in an attempted robbery during a family vacation in Italy. My wife and I donated his organs and corneas to seven very sick Italians, four of them teenagers. We've watched them grow into men and women and, 14 years later, all seven are still alive. Having seen all this I cannot visualise any decision other than the one we made, though to us at the time those people were just statistics on a waiting list.

The main obstacle for most people, I suggest, is this: brain death is usually sudden death—a road accident, a stroke, violence—and people arrive at the hospital to find someone they love, who was in good health only a few hours earlier, now dead or dying. Many are too stunned to take it in, others are angry and looking to assign blame; relations between family members may be tense, almost all are confused about organ donation.

To make a major, irrevocable decision there and then in this highly emotional atmosphere, about something they have never thought about before, is just too much for many people. They say no and often regret it for the rest of their lives. On the other hand, of all the hundreds of donor families I have met, I can scarcely remember one who regretted the decision.

If this is correct, the solution is clear: just as with any other important decision, families should discuss the options in calm conditions, when death is still a distant concept. As the overwhelming majority of

people in most countries say they would donate a family member's organs if they were faced with the choice, I would expect donation rates to soar.

Reg Green
La Cañada, California

SIR – I find it somewhat inconsistent that as a society we are more than happy to profit from the sale of alcohol or cigarettes, the abuse of which indisputably causes medical harm or death, yet we squirm at the concept of creating a financial market for organ donations, which saves lives. As more and more people die needlessly, we might finally end up with a donation system that maximises utility of what shouldn't be a scarce resource.

Austin Locke
New York

Miami Cubans

SIR – I agree with most of the analysis presented in your article on Florida's electorate, though I take issue with the suggestion that Cuban-Americans are becoming more Democratic ("A struggle in the sunshine", October 4th). It is possible that Cuban-Americans may switch their voting intentions over time, because, as you mentioned, they are becoming younger, and recent immigrants tend to be economic rather than political refugees.

The question is, what impact will this have on voting? In the 2004 election those Cuban-Americans who turned out were still very Republican, because younger Cuban-Americans and more recent immigrants vote at lower rates. This could change in November, but we will not know until after the vote. My colleagues and I are conducting an exit poll in Miami-Dade County to test this proposition.

Casey Klofstad
Assistant professor of political science
University of Miami
Coral Gables, Florida

SIR – The fact that you are running a series of articles on the "swing states" only goes to prove that the vote of someone living in a solid red or blue state is inconsequential. The indirect electoral-college system is passé. These few swing states should not be allowed to "swing" the election. I moved to Wisconsin from Texas this year. My vote is being fought over and carries far more weight than say someone who lives in Alabama. The choice of president should be decided by a simple majority of the popular vote.

Hamish Scrimgeour
Milwaukee

Russia and the war effort

SIR – Craig Brown asserted that "the Soviet Union single-handedly wiped out the vast bulk of the Nazi military machine, despite poor communications, mechanical failures and many other problems", which he says is explained by Russian resolve (Letters, October 4th). Winston Churchill himself conceded that the Red Army broke the back of the German *Wehrmacht* in terms of troop commitment, but the idea that Russia got through the second world war without American aid is an oversimplified view that was in fact encouraged by post-war Soviet propaganda.

America's lend-lease programme was vital to the Soviet war economy; the provision of trucks, for example, allowed the Russians to concentrate production on tanks. Nikita Khrushchev admitted in his memoirs that lend-lease was vital to the effort on the eastern front and said that Stalin also acknowledged its role. In 1963 Marshal Zhukov asserted that without American aid the Soviet Union could not have continued the war. And Boris Sokolov, in the first attempt by a Russian historian to assess the impact of lend-lease, has written that "without the Western supplies, the Soviet Union not only could not have won the Great Patriotic War, but even could not have resisted German aggression."

Anthony Martin
London

The state we’re in

SIR – You accurately described how, in France “*l’Etat* has both a capital letter and a cherished place in the popular imagination” (“Lessons from a crisis”, October 4th). I was therefore a little surprised to notice that, on the next page of the same issue, the caption displayed under the picture of Charles de Gaulle read: “*l’état, c’est moi*” (“De Gaulle revived”, October 4th). However, it would appear that more recent events have surpassed British confusion about what should and should not be capitalised. Hasn’t the part-nationalisation of British banks proved that, capital letter or not, *l’Etat, c’est nous*?

Jerome Batout
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Parti Socialiste
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Eastern Europe

Who's next?

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From The Economist print edition



The economies of eastern Europe face stormy times, even if Western banks hold their nerve. The political fallout may be even worse

WILL an ex-communist country be the next Iceland? The dramatic collapse of that country's economy, endangering savings from hapless depositors in Britain and elsewhere, has highlighted other risky but obscure corners of the world's financial system. The stability of the Ukrainian hryvnia, the implications of the Latvian property crash and Hungarians' troubling penchant for loans in Swiss francs are among the exotic topics now crowding policymakers' desks.

Countries such as the ex-communist ones in eastern Europe are particularly at risk during periods of financial turmoil. First, because the counterpart of soaring foreign investment has been gaping current-account deficits (Latvia's, for example, peaked at 26% of GDP in the third quarter of last year). Second, their central banks and governments are unlikely to be able to muster the financial firepower now being deployed in the big economies of the West. Already a couple of banks have toppled; stockmarkets have plunged, wiping out years of savings and hitting balance-sheets. The price of credit-default swaps—the market's estimation of a borrower's creditworthiness—ranges from the reassuring to the alarming (see map). As worries intensified, Hungary's central bank on October 22nd raised interest rates from 8.5% to 11.5%.



For countries that have benefited from big flows of outside money, delivered by a highly leveraged global financial system, the mix of problems looks scary. Those big current-account deficits in every country save Russia suggest they may be living beyond their means. Some (but not all) have public or private sectors with big foreign debts; these may be hard to refinance. Some (again, not always the same ones) have wobbly banks and large state deficits. At best, the region is in for more nasty shocks that will need external support from lenders such as the IMF. At worst, some countries face debt restructuring, currency collapse and depression; that raises the spectre of political upheaval, too.

The turmoil has been most spectacular in Russia. There the stockmarket has plunged by some two-thirds since its peak in May, sending its fabled oligarchs scrambling to liquidate their portfolios to meet bankers' demands. Oleg Deripaska, probably the richest of these well-connected tycoons—now embroiled in a British political scandal (see article)—has sold prized stakes in Western companies which he had pledged as collateral in the $4.5 billion acquisition of a 25% stake in Russia's biggest metals producer, Norilsk Nickel.

These wild shifts in fortunes reawaken memories of the 1998 financial crash, in which default and devaluation wiped out most of Russia's private banking system. But few expect a reprise. Thanks to $1.3 trillion in oil and gas revenues over the past eight years, Russia now sits on a mighty pile of cash and liquid assets, still in excess of $500 billion, in its foreign-exchange reserves and other funds. It is unclear how well the Kremlin will organise the bail-outs and who will benefit. A lower oil price may affect the geopolitical ambitions of Russia and its allies (see article). Some oligarchs may become minigarchs. But Russia will not need to beg for cash from the outside world.

In Ukraine, the next-largest country in the region, the story is quite different. The stockmarket has plunged by nearly 80% this year. The hryvnia, the national currency, recently hit a seven-year low against the dollar. The sixth-largest bank, Prominvest, suffered a run. Rating agencies have issued downgrades. Economic growth is plunging. Inflation is 25%.

The outside world wants to help. Officials are haggling with the IMF about an emergency loan of up to $14 billion—around a fifth of the $55 billion-66 billion that Ukraine needs to raise by next year to roll over short-term loans, pay interest on other debts and finance the rest of its current-account deficit. That would normally require hard bargaining about banking reform, higher interest rates and a stringent public-spending regime to curb inflation.

The problem is that Ukraine, even by its own awful standards, is in political chaos. The prime minister and president are at loggerheads about whether an impending general election (now postponed until

December 14th) is legal. A new government able to take tough decisions will not be in the saddle for weeks, even months. Keen not to be seen as too slow to assist, the IMF may stump up a loan nonetheless.

Lifelines from outside

The IMF is one source of help (and may be happy to have something to do after years in which its role in the region seemed to be shrinking). For countries closer to “old Europe”, another possible provider of assistance is the European Central Bank. On October 16th the ECB provided a short-term credit line of €5 billion ($6.7 billion) to Hungary, which is not in the euro zone but has an economy closely linked to it. The foreign-exchange market there had all but seized up amid worries about debts, public finances and growth prospects.

Although much richer than Ukraine, with GDP per head roughly three times as high, Hungary is in some senses even more vulnerable. Public debt is more than 60% of GDP (a lot by the region’s standards), thanks to a communist-era borrowing spree and spendthrift governments since then. In 2006 the budget deficit exceeded 9% of national income. The current-account deficit this year amounts to €6.8 billion, or 5.5 % of GDP. Recent debt auctions have been cancelled because of a buyers’ strike. Many Hungarian households and firms have taken out hard-currency loans (such loans, originally at much lower interest rates than forint-denominated ones, account for 90% of new mortgages since 2006 and 20% of GDP). In effect these were personal bets, now looking ill-judged, on the convergence of the forint with the euro. The weak forint already means higher interest payments; if that trend continues, many Hungarians risk bankruptcy.

Hungary’s economy could certainly be in better shape. But outsiders give the authorities credit for efforts in the past two years to cut the budget deficit, now slightly less than 4% of GDP. The government has started cross-party talks on a further austerity programme. The Hungarian central bank is impressively well-run. The IMF and ECB are ready to lend more if needed.

The huge question, in Hungary and elsewhere, is whether foreign banks will stand by their local customers. Like most of the new members of the European Union, Hungary has sold off most of its banks to outsiders. That once looked the best way to create a solid financial system, allowing countries to borrow freely and grow fast, without risking the kind of crisis suffered by emerging markets in past decades. In retrospect, it looks risky. For the past decade Western banks, such as Erste Bank and Raiffeisen (Austria), UniCredit (Italy) or Swedbank and SEB (Sweden), have piled in to the promising new markets on their doorsteps, lending boldly and buying up sometimes richly priced local banks. Now those huge loan books—in Austria’s case fully 43% of GDP, compared with 5% for Italy and 1% for Sweden—are souring at a time when wobbly banks may feel that scarce cash is better deployed at home. Such deposits abroad are not covered by home-country insurance.

The foreign banks are already reining back lending, refusing to issue mortgages in foreign currency and demanding better security. That is prudent, if belated. The danger is that they may go much further, cutting off new lending or refusing to roll over outstanding loans, even to solid borrowers. That could send bankruptcies and unemployment rocketing. Another possibility is that one or more parent banks will put a troubled subsidiary up for sale, perhaps to a Russian buyer. That prospect is unlikely. But it sets nerves jangling in places such as the Baltic states.

At first sight it is these economies that seem in the riskiest position. A sharp slowdown had started even before the global financial crash. Estonia and Latvia in particular had enjoyed remarkable property booms, generously financed by bank lending. That was one factor in their colossal current-account deficits. The bubbles have popped; growth, running in double digits in 2006, has come to a halt.

This has been a hard but so far orderly landing. Whether it now turns catastrophic is an open question. The debts must still be repaid. Fitch, a rating agency, which downgraded all three Baltic countries this month, reckons their gross external financing requirements next year (the money they need for foreign debt repayments and their current-account deficits) are 400% of likely year-end foreign-exchange reserves in Latvia, 350% in Estonia and 250% in Lithuania. These are the highest ratios in emerging Europe.

In theory, the external imbalances should unwind of their own accord. The slowdown at home is already shrinking current-account deficits. If the local banks run out of money because of bad loans, their foreign owners will send them more cash; the sums involved are big by Baltic standards, but small by the standards of rich-country banks. Swedbank, for example, has 16% of its loans in the Baltic states, (190

billion Swedish kronor, equivalent to $32 billion or €20 billion). Only 1.2% of the total look bad so far, the bank says. Sweden's regulators say the biggest banks can write off as much as 10% of Baltic lending without eroding their own capital. Sweden launched a $200 billion bail-out plan this week to bolster confidence.

Furthermore, despite the ballooning foreign borrowings of firms and households, none of the Baltic states has much public debt to worry about (Estonia even has net assets). Public finances are solid. The governments still have investment-grade credit ratings.

Pegs and their dangers

The problem is not so much survival, as finding the right policy mix to minimise the effects of sharp slowdown. All three Baltic states have their currencies pegged to the euro, either in formal currency boards (where the amount of money in circulation is directly linked to foreign-exchange reserves) or, in Latvia's case, in a similar but slightly more flexible arrangement. That was a shrewd move in the 1990s, when it helped to stabilise economies left prostrate after the collapse of Soviet planning, and was a good way of keeping on track for eventual membership of the euro (something Lithuania missed by a statistical whisker in 2006). It is made safer by the fact that none of the countries is a financial centre: shorting the Icelandic krona was child's play compared with the difficulties of speculating in the thinly traded Latvian lat or the Estonian kroon.

The main disadvantage of the arrangement is that it limits policymakers' flexibility. If outsiders suddenly pull money out of a country with a pegged currency, the money supply shrinks, risking a deep depression. A country with a floating exchange rate can try to restore competitiveness and stoke growth by devaluing the currency. For any of the Baltic states, a float would be a catastrophic humiliation. It would also not necessarily help matters: for small countries, the risks of a free-floating currency are greater and the benefits less. So the likelihood is that the three Baltic countries face, at best, big cuts in public spending and lower output, perhaps for several years, while they pay off their debts and regain competitiveness. In happier conditions the governments would run deficits to counter this. In the current gloom, more borrowing risks making outside lenders feel even twitchier.



Most of the EU's new members are in a stronger position, and should scarcely be put in the same category as the problematic countries. Poland, for example, has public debt of around 40% of GDP, while growth is nearly 6% and inflation at 4.5%. A strong economy has meant healthy tax revenues and kept budget deficits down. The zloty, like the Hungarian forint, has been wobbly, and a sharp slowdown in western Europe, the biggest export market for all ex-communist countries, will affect Poland too. But life should be at worst a bit tougher, rather than downright nasty.

The price of corruption

Potentially more vulnerable are the poorest new members of the EU, Romania and Bulgaria. For now, growth in both countries remains strong. But the imbalances are striking: Bulgaria's current-account deficit is likely to be 24% this year. Bursting property bubbles and a wave of corporate bankruptcies could expose the poor quality of banks' loan books. The question then will be how much support and attention either country will receive from outside. Whereas the Baltic states are well-regarded, enthusiasm in the EU for a Bulgarian bail-out is likely to be limited, thanks to the failure of the authorities in Sofia to fulfil commitments to clean up organised crime and corruption.

And that is the deeper problem for eastern Europe: not so much financial wobbles and weaknesses, but corrupt and incompetent politics. Their leaders found it hard enough to govern efficiently even when times were good. What will happen when foreign investors are stingier and growth slows or stops?

Ever since the collapse of communism in 1989, the eastern half of Europe has been struggling to reach

the levels of economic, social and cultural development of the west. The ruinous legacy of one-party rule and planned economies was daunting. Everything from the rule of law to competitive companies needed to be rebuilt (in the case of the central European countries) or constructed from scratch (for those whose pre-communist experience was of autocracy or feudalism).

The results were impressive. Living standards soared; foreign investment poured in; politics settled down. The richest ex-communist countries are now nearing “Western” countries such as Greece and Portugal. So the fears of some in “old Europe” in the early 1990s that the new neighbours were likely to be poverty-stricken and unstable, exporting hungry migrants and crime to the rest of the continent, looked ridiculously overblown. Expanding the EU and NATO eastward went from a preposterous fantasy to common sense. One small ex-communist country, Slovenia, has joined the euro; another, Slovakia, will do so in January.

The next few years are likely to be a lot harder. A sharp recession will expose the cost of stalled reforms in previous years. In most of the ex-communist countries, the effort to meet EU and NATO requirements was a high-water mark in terms of political commitment to good government and sound economic policies. Since then, the approach has been to sit back and enjoy the weather: low borrowing costs, high foreign investment, rising tax revenues and higher living standards. Voters may not have thanked governments for this, but the political pressure to take painful decisions has been minimal. (The only real exception has been Hungary, where capital markets sent a sharp warning two years ago.)

Testing democracy

Now more than ever, the countries of the region need to push ahead with tough but urgent policies such as public-finance reform, especially of pensions; raising labour-market participation, particularly by reducing the numbers of early retirees; and improving productivity by modernising education, which is often still hidebound by communist-era bureaucracy. Countries such as Poland and Latvia still have shamefully bad road systems. Officialdom chokes business; corruption is stubbornly entrenched.

But the chances of a big push on reform look slim. The political compass, which once sent a reliable, if often ignored, message about the needed direction of policy, is swinging wildly as Western governments break taboo after taboo in the hope of fending off financial meltdown. For countries that have been told that privatisation, liberalisation and balanced budgets are the sure path to salvation, these are confusing times. The result, says Ivan Krastev, a Sofia-based pundit, is “an implosion in the idea of normality”.

The wrong kind of certainty may be even worse than confusion. The political institutions of the ex-communist countries were created in the great flush of optimism that followed the collapse of the one-party state. But voters have grown steadily disillusioned with politics. A seasoned watcher of the region in Brussels says that the coming years “will be a big test of democracy and the rule of law…will they stick to the rules?” If things get nasty, blaming economic hardship on foreign banks that have taken deposits but don’t want to make loans may prove a tempting theme for ambitious populist politicians.

For countries still outside the main clubs, prospects are even bleaker. The chances of fragile countries such as Macedonia joining the EU any time soon are diminishing. So are the prospects for the more advanced countries that want to join the euro. A cash-strapped EU may think again about the money it is prepared to spend on infrastructure and public services in neighbouring non-members.

In the eyes of many it is market economics, even more than democracy, that has been the big success of the past 20 years. It has brought undreamed-of freedom, choice and prosperity. In some countries, Mr Krastev notes, foreign banks have scored more highly in trust rankings than any public institution. They have become the symbolic and financial linchpins not just of economies, but of whole countries. They have a lot to lose. So does Europe.

The ground campaign

Obama's earnest army

Oct 23rd 2008 | RALEIGH
From The Economist print edition

Barack Obama's get-out-the-vote machine is bigger, faster and smarter

eyevine



ALL kinds of fun can be had at the North Carolina State Fair. You can watch pig races, chomp steak-on-a-stick and marvel at Sampson the Giant Horse. Both kinds of politics are also on offer. The Republican booth, with an elephant sign hanging from the ceiling and attractive female volunteers, is even more crowded than the cake-baking contest next door. Scott Daughtry, a retired park ranger in overalls and a straw hat, asks for a bumper-sticker for his pickup. He's backing John McCain because the Arizona senator "thinks murdering little babies is not a good idea".

The Republican vote-mobilising machine is still pretty good at the things it has always done well. Its operators know all the traditional ways to reach conservative voters. Give them a state fair packed with white southerners, gun-owners and married couples with children, and they do an expert job of putting leaflets into sympathetic hands.

By contrast, the Democrats at the fair seem out of their comfort zone. They have hardly any stickers to hand out, having read and taken literally an obscure rule barring the practice. Their booth attracts few punters. A PowerPoint presentation about the exorbitant price of milk plays on a loop to no one in particular. It is usually busier, insists an Obama volunteer.

At first glance, this scene bodes ill for Democrats. But step back and the picture changes. How on earth can the race in North Carolina be competitive? The state has not voted for a Democratic president since Jimmy Carter in 1976—and he was a Southern Baptist, a military veteran and the governor of the next-door state of Georgia. Yet Barack Obama, a black liberal from Chicago, is slightly ahead in the polls. And if he can win North Carolina, he is on course for a landslide.

The polls are close, not just in North Carolina but in a dozen other states. Yet they underestimate Mr Obama's strength, for his get-out-the-vote operation is far superior. He may be outgunned at the North Carolina state fair, but this is a place Republicans normally take for granted. Mr Obama is pushing deep into red America, forcing his rival to spend time and money defending his base when he badly needs to pour both into traditional swing states like Ohio and Florida.

Mr Obama can do this because he has oodles of money. He raised a record-smashing $150m last month. That is nearly twice what Mr McCain can spend on his whole campaign, though the Republican Party is chipping in to help him. Mr Obama also enjoys a larger pool of passionate fans from which to recruit volunteers. A *Washington Post* poll this week found that 64% of Mr Obama's supporters were "very

enthusiastic", while only 40% of Mr McCain's were. And the Obama campaign is using technology much more creatively to rally its supporters.

In North Carolina Mr Obama has a whopping 45 field offices. Mr McCain claims 40, but these are simply local Republican Party offices, which have to handle local and congressional races as well. Mr Obama's offices are his own. Each one is typically led by a paid staffer, but nearly all the work is done by the 17,000 volunteers Mr Obama has recruited in the state. (The Republicans won't say how many volunteers they have.)

Some of Mr Obama's volunteers sign up the old-fashioned way, in person. Others volunteer online. In their local corner of the Obama website, they can meet other Obamaphiles and arrange to knock on specific doors in their neighbourhood. They can download information about who lives in each house, which party they belong to and what they told the last phone canvasser. They can update this information each time they meet a voter. They can also spend hours on the website chatting with like-minded people, watching the candidate's speeches and uploading their own Barack-related videos.

The McCain campaign has nothing like this. It does use e-mail (a technology the candy-munching young techies on the Obama campaign consider "traditional"), but it has barely begun to grasp the possibilities of online social networking. "The internet is something we're playing catch-up on," admits Brent Woodcox, a spokesman for the North Carolina Republican Party.

For all its pretensions to be about "you", the Obama campaign is strictly hierarchical and impressively disciplined. Most staffers cannot speak to journalists or even show them around without approval from head office in Chicago. Volunteers manning the phones are given a detailed script. In North Carolina they tell undecided voters two things about Mr McCain: that he "has proposed tax breaks for companies that ship jobs overseas" and that he wants to give "tax breaks of $4 billion per year for oil companies". Both claims are misleading. The first refers to an old rule that American multinationals need not pay taxes on profits earned abroad until they repatriate them. The second refers to Mr McCain's plan to cut corporate taxes in general.

Mr Obama's eager foot-soldiers put in very long hours. Boo Walukas, for example, says she works 40 hours a week as a nurse and another 40 knocking on doors. With a "Boobama" badge on her nurse's uniform, she drives around Cary, the suburb where she lives, urging Democrats to vote early. North Carolina is one of 34 states that allow people to do so: around a third of Americans will have voted before election day. "If you vote early, folks like me will stop knocking on your door," says Ronnie ("Ronniebama") Chapman, another volunteer.

In other states the story is similar. In Virginia Mr Obama has 70 offices to Mr McCain's 21. In populous and safely-blue California, hordes of arty types with time on their hands are calling waverers in Nevada, New Mexico and Colorado, or driving across state lines to knock on doors. In Texas, which is a lost cause, Obama supporters are being urged to telephone or even travel to Ohio, which is not. Nationwide, Mr Obama is spending four times more than Mr McCain on TV spots. Online, he has more than 100 times as many ads.

One hesitates to write off Mr McCain, who has escaped four times from disintegrating fighter planes. But he has his work cut out. At the state fair, as Mr Daughtry, the former park ranger, takes his McCain bumper-sticker, he mutters: "We're not doing too well, are we?" A volunteer replies, hopefully: "Don't believe the polls!"

Prediction

Poll, baby, poll!

Oct 23rd 2008 | NEW YORK
From The Economist print edition

But will polling accurately predict the outcome of November's election?

IN LATE August, when most polls showed Barack Obama losing his lead over John McCain, Mr Obama's campaign manager, David Plouffe, pooh-poohed the reports. "We don't pay attention to national polls," he said. Today, the question on many Americans' minds is whether they should either.

The volatility of polls give good cause to wonder. Each day, a slew of new ones hits the American press, but they very seldom agree. Polls this week, for instance, showed Mr Obama with a lead as great as 14 percentage points or as small as zero.

One way that polls can be wrong, some say, is because of the high percentage of young people without landlines. Polling organisations usually call landlines, because federal regulations targeting telemarketers makes it illegal to dial mobile numbers automatically. But after a recent study by the Pew Research Centre, a non-partisan opinion research group, found that the exclusion of "mobile-onlys" (who are mostly young and pro-Obama) could introduce a bias into survey data, many polling organisations now feel pressure to invest the money and time to have humans call more mobile phones. Still, only some of them do so, and to differing extents, which could help explain the wide variation in polls on any given day.

Another concern that has attracted much attention is that polls may show a lead for Mr Obama that will not hold true in the actual vote, because some respondents want to appear politically correct even though they will not vote for a black candidate. This phenomenon, usually called the Bradley effect, is highly controversial, and many people dispute its relevance to the 2008 election, arguing it has not been demonstrated in elections involving black candidates in the past decade. (Indeed, some say the so-called Bradley effect did not even apply to Tom Bradley, an African-American, who ran for governor of California in 1982.) Even if the Bradley effect does not yield a drastically different election result than polls forecast, it is entirely possible that an "Obama effect" might, should he drive supporters to vote in even greater numbers than pollsters anticipate.

Polls are most likely to be misleading because of bad methodology. While every poll should strive to get a representative sample of likely voters, many fail. Online surveys are notoriously biased, because respondents are self-selecting. Postal surveys have low response rates, and in-person telephone polls are cripplingly expensive to do. Some polling organisations, like Rasmussen Reports, weight the responses of less represented groups more heavily. But most experts consider this a sloppy way to compensate for a biased poll.

The deficit

How big is too big?

Oct 23rd 2008 | WASHINGTON, DC
From The Economist print edition

The government is deep in the red

IT IS bad enough that Americans are on the hook for $700 billion to bail out their country's mortgages and banks. But the financial crisis is about to visit even more serious fiscal harm on the economy by shrinking one of the Treasury's plumpest sources of tax revenue.

Between 2004 and 2007, the budget deficit narrowed from $413 billion to $162 billion in large part thanks to rapid growth in tax revenue. This was caused not just by rising incomes, but also by a shift in the distribution of incomes to the wealthy, who pay the highest tax rates. Much of that wealth came from the credit boom which drove up financial profits, salaries and bonuses as well as property and stock values and related capital gains.

But that means the financial bust is almost certain to crush the government's tax take. It has already started: the budget deficit for fiscal 2008 (which ended on September 30th) was $455 billion, or 3.2% of GDP, much more than the $389 billion projected in July. Much of the shortfall appears due to lower taxes on profits and the wealthy.

In early September, just before Lehman Brothers' bankruptcy plunged the world into financial turmoil, the non-partisan Congressional Budget Office reckoned the deficit for fiscal 2009 would be around $438 billion. But Peter Orszag, the agency's director, now thinks it will be at least $750 billion, due both to the recession's impact on revenue and spending (such as for unemployment insurance) and costs associated with various government bail-outs. At 5% of GDP, that would be the highest level since 1986.

In fact, though, the deficit will probably be far larger. J.D. Foster, an economist at the Heritage Foundation, notes that earlier this decade, when he worked in the White House budget office, the dotcom crash led to a loss of revenue equal to 2% of GDP beyond what a weaker economy alone would account for: it resulted from lower capital gains, stock options proceeds, bonuses and other sorts of income that are highly correlated to financial markets. That would equate to about $300 billion in today's economy. Mr Foster thinks the hit this time around will be even bigger because the recession is likely to be deeper than 2001's mild episode and the pain on Wall Street greater.

Then there's the prospect of additional fiscal stimulus, which won support on October 20th from Ben Bernanke, the Federal Reserve chairman. The Democrats in Congress, who already have a $61 billion package in the works, are now suggesting $150 billion. Barack Obama has proposed up to $190 billion over two years, and would merge that proposal with Congress's one should he become president. Republicans and John McCain have countered with separate grab bags of tax cuts, though continued Democratic control of Congress dooms such plans in their current form.



The $700 billion Troubled Asset Relief Programme (TARP) will also add to the deficit, though less than might appear. Mortgages or bank equity earn income and can later be sold; they are not a drain on the Treasury like a tank or a dole cheque. So when the Treasury purchases debt, it will only book a cost to the extent that it pays above the market price. Oddly, though, when it purchases equity in a bank it will book the full cost in that year's budget. Since it plans to invest $250 billion in bank equity, the addition to the deficit this year will be at least that much.

This all threatens to add up to a deficit of at least $1 trillion, or nearly 7% of GDP, this fiscal year, a

figure that is likely to force the next president to postpone some of his more ambitious proposals. Still, even fiscal hawks concede a higher short-term deficit is a tolerable price for avoiding a potential depression—though a 7% deficit is probably testing their tolerance. And at present the American government can borrow at absurdly low interest rates: 1% for three months or about 4% for 30 years.

Yet it cannot take its lenders for granted. This year, the Treasury may have to raise more than $1.4 trillion in debt, according to Morgan Stanley, to finance not just the deficit but the TARP and the Federal Deposit Insurance Corporation. “It’s going to be painful to be faced with humungous auction after humungous auction especially when competing against Europe,” which is funding its own bail-outs, says one Wall Street analyst. The Treasury got a warning of this earlier this month, when yields on its bonds briefly spiked.

America has long borrowed without fear of a backlash, thanks to lenders’ lack of attractive alternatives. And it may for a while yet: much of the private sector either can’t borrow or doesn’t want to, and other countries also face yawning deficits, making them far from attractive. The national debt, at 38% of GDP, is well below its 1990s peak of 49%. But much of the deficit is still financed by foreigners, and global capital flows are now being rocked by the financial crisis. The next president will no doubt find deficits at 7% or more of GDP sobering enough. Without a plan for cutting that high figure back once the financial crisis and the recession pass—and with the inexorable climb in Medicare and Social Security costs as the baby-boomers retire now under way—investors may need to be compensated much more than they are now to keep on buying America’s debt.

Women voters

Hard to get

Oct 23rd 2008 | TROY, MICHIGAN
From The Economist print edition

John McCain has tried to win women's votes, but Barack Obama still leads

ONE month ago Kim Francisco seemed like the Obama campaign's worst nightmare. White, married and blue-collar, Ms Francisco fits into the group John McCain has tried to woo away from Barack Obama—not least by choosing Sarah Palin as his running-mate. And on September 26th wooed she was, wearing a Hillary Clinton cap and a Sarah Palin button to a McCain event in Michigan. But fears that Ms Francisco and her kind will topple Mr Obama are proving unfounded. Women across the country favour the Democratic nominee, by 54% to Mr McCain's 39%, according to Gallup's most recent poll. Indeed women support Mr Obama by a greater margin than they did John Kerry (51% to George Bush's 48%) or Al Gore (54% to 43%).

Women vote in larger numbers than men, and have done so in every election since 1964. Mr McCain's great hope has been to win a greater share of white women. Working-class women who supported Mrs Clinton during the primaries are particularly good targets, as are married suburbanites, older women and small-business owners, says Susan Carroll of the Centre for American Women and Politics. Mrs Palin, the early wisdom went, would help in the endeavour.

The reality has turned out to be more complicated. True, the pro-gun, pro-God, pro-life mother of five has appealed to some women. When Mrs Palin drew nearly 20,000 to a rally in Indiana on October 17th, Janice Legg took a short cut through a ravine so as not to be late. She explained that Mrs Palin is "like us" and is the reason she will vote for Mr McCain. Others are less keen. A whopping 60% of women aged 50 and younger have a negative view of Mrs Palin, according to a poll released by the Pew Research Centre on October 21st. Mrs Palin has also had only a fleeting impact on white women. After the Republican convention white women favoured Mr McCain over Mr Obama by 51% to 40%, according to Gallup. They now favour Mr Obama by 47% to 46%.

The financial crisis and growing doubts about Mrs Palin have boosted support for Mr Obama. But it also helps that he has targeted women for months. Efforts have included speeches, discussion groups and reports that describe his plans' economic impact on women. Michelle Obama has campaigned with gusto, as have a long list of female Democrats. Mrs Clinton has also joined in, though attempts to win her supporters have not been seamless. PUMA (the acronym is for Party Unity My Ass) is one of the groups less than thrilled by Mr Obama's ascent. Still, he has made progress. A *Washington Post*/ABC News poll on October 13th found 81% of Mrs Clinton's voters supporting Mr Obama.

Despite the high-profile efforts mentioned above, the campaign's most striking activity is on the ground. Driven by internet organising, volunteering has taken many forms, from phone banks to canvassing and small gatherings. A house party last month in Ozaukee County, Wisconsin, saw some 40 women and a few brave husbands stream through Lynn Handler's front door, past a sundae bar (for later) to the living room, where they discussed Mr Obama's record on abortion rights, equal pay, domestic violence and women's health.

Mr McCain has left traditional women's issues to Mr Obama—in the final debate the Republican candidate derided women's "health" as an excuse for abortions. The campaign is instead pursuing women through broad arguments of character, leadership and policy—something similar to the appeal to "security moms" that worked well for George Bush in 2004. "Women for McCain" coalitions have been rolled out in key states; women's phone-banks are held each Monday. But time is running out. In 1984 Geraldine Ferraro at first achieved a bump in the polls for her running mate, Walter Mondale. But the pair lost the election anyway.

Senate races in the South

Scrambling the red states

Oct 23rd 2008 | ATLANTA
From The Economist print edition

Several southern Republicans are facing defeat thanks to Barack Obama

SIX months ago Saxby Chambliss looked a safe bet for re-election. During his first term, Georgia's senator ruffled some feathers among Republicans with his support for bipartisan immigration reform. But Georgia is a conservative state, and the Democratic challenger, a former state representative called Jim Martin, is a mild-mannered fellow who lags in money and name recognition. So Republicans must be annoyed that the race is now nearly tied. An October 17th poll from Research 2000 has Mr Chambliss up by just two points.

What happened? Like many Republicans, Mr Chambliss has an Obama problem. Though the Obama campaign once planned to contest Georgia, it has focused its resources on more amenable southern swing states like North Carolina and Florida. But there is still a substantial Obama infrastructure in the state, hundreds of thousands of new voters have been registered, and enthusiasm is running high. "Clearly we're going to have the largest African-American turnout in the history of Georgia," says Merle Black, an expert on southern politics at Emory University in Atlanta. It may not be enough to win the state for Mr Obama, but it will help other Democrats on the ballot, such as Mr Martin.

The economy has become an even bigger headache for Mr Chambliss. He voted for the bail-out, as did Georgia's other Republican senator, Johnny Isakson. Georgia's seven House Republicans voted against the measure. They later held a joint appearance with Mr Chambliss to show Republican solidarity, but voters are furious. "I want them to track my money and see what portion of it they're using for the bail-out," says Brenda Petty-Moore, a retired librarian in Atlanta.

The damage was obvious at a rowdy debate held on October 9th at the Georgia National Fair in Perry. Mr Chambliss defended his vote on the bail-out as the lesser of two evils. But he clearly wanted to talk about anything but the economy. He bragged that Robbins Air Force Base had made it through the latest round of realignments and closures, and attacked Mr Martin for a 1995 vote against making English the official state language. Later he struck an Obama-esque note: "You know, this is a very complex world we live in. The simplistic answers that come from my opponents are not going to work, folks."

That is a fair point. And Mr Chambliss is one of the few vulnerable incumbents getting pummelled over his vote on the bail-out, because he is one of the few vulnerable incumbents who voted for it. But there are several southern senators who could use a rescue package of their own. Elizabeth Dole in North Carolina has seen her race tilt Democratic in the past two months. The challenger, Kay Hagan, has portrayed Mrs Dole as a Washingtonian who spends too much time with George Bush to visit North Carolina, and has benefited from the Obama wave.

In Mississippi, another Democrat, Ronnie Musgrove, is trying to ride that wave without seeming to enjoy it too much (Mr Obama is still hard to sell to older, conservative white Democrats). The state has two Senate races this year; one is a safe Republican seat, but the other, a special election for Trent Lott's old seat, is a virtual tie. The incumbent Republican, Roger Wicker, got the seat by appointment. Mr Musgrove, a former governor, cleverly gives the impression of supporting Mr Obama only because Washington so badly needs a change.

Next door is Louisiana, where Republicans once thought they might be able to pick off the Democrat Mary Landrieu. The Republican, John Kennedy, is on the attack. He says that Ms Landrieu has voted with the liberal Mr Obama 81% of the time. But a bad economy helps the Democrats, and she has inched back into the safe zone.

This was bound to be a tough year for Senate Republicans. A third of Senate seats are up for election every two years, and this time it happened that more of them were Republican. The Democrats will surely expand their majority in the Senate. Now the question is whether they will end up with 60 seats, which would let them swan past any Republican filibusters.

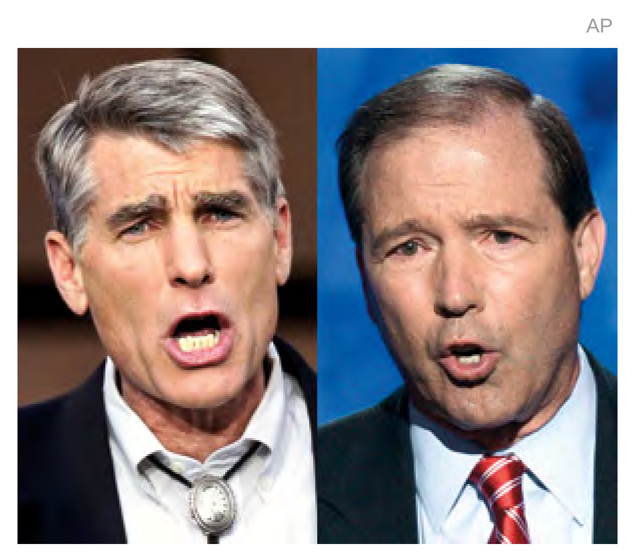
The Udalls

Lords of the West

Oct 23rd 2008 | ALBUQUERQUE AND DENVER
From The Economist print edition

The family history continues

AP



Tom, meet Mark

OVER the course of his career, Morris “Mo” Udall, who served as a Democratic congressman from Arizona for 30 years and ran for the presidency in 1976, kept an ever-expanding file of jokes to use on his audiences. Mark, his son and a congressman from Colorado running in one of the most exciting Senate races this year, confesses to doing the same thing. He says that people tell him he is not as amusing as his father. That might be a blessing: Mo Udall entitled his political memoir “Too Funny to be President”.

“Vote for the Udall nearest you,” Mark nevertheless jokes after a campaign stop in a suburban park north of Denver (the surname is pronounced “you-dal”). His staff, though, are pretty dusty when people bring up the d-word. Dynasty is a political expletive in a country wary of inherited privilege. Mr Udall’s handlers gamely insist that family doesn’t come up much. A lot of voters, one claims, don’t even realise that he has a cousin, Tom, the Democrat running for the Senate in New Mexico.

But there are few dynasties in America as celebrated as the Udalls, members of which have held office across the West for generations. David King Udall, Tom and Mark’s great-grandfather, led a group of Mormons to settle in northern Arizona, where hostile locals had him arrested. Barry Goldwater’s father bailed him out of jail. While he was incarcerated his lieutenant, Miles Romney—Mitt Romney’s great-grandfather—took over.

David King Udall sired two chief justices of the Arizona Supreme Court and a mayor of Phoenix. The third generation included Mo and his brother, Stewart, who was a congressman and John Kennedy’s secretary of the interior. When he thought about entering politics, Mo once recounted, he had to consider running for Congress against his brother or running for the state Supreme Court against his uncle.

Now Tom and Mark are both tipped to win Senate seats. Poll averages have Mark ahead by nine points and Tom ahead by 18. Meanwhile, Gordon Smith, their second cousin, is already in the Senate representing Oregon. He descends from David King Udall’s second wife (he was a polygamist); but he is a Republican, and he trails by four points in his re-election battle.

What makes the West such fertile ground for Udalls? Family connections help. But Mark Udall reckons that when you’re building irrigation ditches—or, nowadays, creating a drought-information system—results matter most. Tom Udall proudly lists the wilderness areas he has preserved and speaks of his father’s decision not to build a dam in the Grand Canyon. Mark Udall calls environmental conservation the

Udalls' "eleventh commandment", which endears them to their states' Democrats as well as their hunters and fishermen. Both gush about investing in alternative energy.

Mark Udall's opponent, Bob Schaffer, counters that he really just wants to expand government. Both Udall cousins vote with their party nearly all the time, and Mr Schaffer's supporters have spent over $10m reminding voters of this. But big spenders or not, the Udall cousins are running in the right year. The national political climate, combined with an influx of coastal liberals, has made Colorado and New Mexico swing states. For now it seems, the West hasn't had enough of the Udalls, at least not of the Democratic variety.

Western economies

The Mormon work ethic

Oct 23rd 2008 | SALT LAKE CITY
From The Economist print edition

Why Utah's economy is soaring above its neighbours

NOBODY knows quite how the contagion that broke out in Wall Street will affect the rest of America, nor how deep or how long the likely recession will be. What is certain is that some places will suffer more than others. So far Utah, a state best-known for Mormonism and pretty rocks, is looking unusually healthy. "We've got a lot to be proud of," says Jon Huntsman, the governor. "Certainly more than many of our neighbours."

Indeed, Utah has more to be proud of than any other state in the West. In September its unemployment rate was just 3.5%—less than half of California's and the second-lowest rate in the region after oil- and gas-rich Wyoming. Last month the Milken Institute declared Provo, a sprawling settlement south of Salt Lake City, America's best-performing city for technology output and job and wage growth. Salt Lake City itself came third.

Hardly a month goes by without Utah announcing a corporate relocation or a new factory. The state has experienced a minor semiconductor boom in part because of its cheap, coal-fired power. Ogden, until recently a decaying railway town north of Salt Lake City, has quietly become the world centre of winter sports equipment. Mike Dowse, who oversees brands such as Atomic and Salomon for Amer Sports, gives three reasons: "the mountains, the mayor and the money".

The mountains are the Rockies, which lure young workers who like to go skiing. The mayor is Matthew Godfrey, a business-minded man who has aggressively recruited several companies to Ogden (Mr Huntsman, a former chemicals executive, likes to work the phones, too). The money, which comes partly from the city and partly from the state, is a mixture of relocation grants and tax breaks tied to the creation of well-paying jobs.



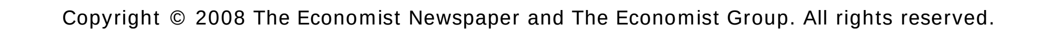
Utah's housing market is relatively healthy, largely because it did not heat up too much in the middle of

this decade. In August its foreclosure rate was lower than the national average. Nevada, Utah's neighbour to the west, had America's highest rate of foreclosure filings, according to Realtytrac. California had the second-highest rate and Arizona the third. Colorado's front range, which includes Denver, is also littered with abandoned houses. Such areas have suffered from sharply falling property prices, reduced consumer spending and job losses among construction workers.

Another, hidden, source of strength is Utah's strange demography. Mormons tend to start families young: the average Utah woman marries at just 22. That means the "echo boom"—the peak of childbearing by baby boomers—took place not around 1990, as in the rest of America, but ten years earlier. One reason unemployment is rising across the West is that a wave of teenagers is crashing onto the job market. Utah, by contrast, has few teenagers and lots of productive people in their late twenties and early thirties. "The timing is pretty good for a recession," says Pam Perlich of the University of Utah.

The "cultural thing", as businessmen from out of state delicately refer to Mormonism, helps in other ways. Utah's almost universal conservatism makes for stable, consensual politics. It took the state legislature just two days last month to plug a $272m hole in the budget. By contrast, California's budget was 85 days late. Nevada's politicians are preparing for a nasty fiscal fight next year.

Mormons do not come to work nursing hangovers, and they are inclined to stay put in the promised land rather than pursue better-paying jobs elsewhere. Matthew Donthnier, who is hiring for a new Procter & Gamble plant, has only one complaint about the local workforce: it can be a little difficult to persuade people to toil on Sundays.





Swing states: Pennsylvania

McCain's last stand

Oct 23rd 2008 | SCRANTON
From The Economist print edition

The Republican contender is hoping for a surprise victory in Pennsylvania

JOHN McCAIN began the final fortnight of this seemingly endless presidential campaign by barnstorming across Pennsylvania. He hammered away at his rival's inexperience and naivety, to great applause, and argued that his "outdated" economic ideology could produce another Depression. But will it work?

Pennsylvania is the odd man out in the current election campaign, the only big state that voted Democratic in 2004 that Mr McCain is still devoting serious resources to. The airwaves are crackling with political ads (the campaigns have spent a combined $27m on them since mid-June). Big supporters drop in almost every day.

Pennsylvania is vital to what Mr McCain calls his "narrow victory" strategy—eking out just enough votes in the electoral college to win the White House. If Mr McCain can capture Pennsylvania's 21 electoral votes, he can offset Barack Obama's gains in Republican strongholds in the Mountain West; if he loses Pennsylvania, his goose is probably cooked.

Pennsylvania has not voted Republican in a presidential election since 1988. Mr Obama is leading by 8-15 points in recent polls. The state's two biggest cities—Philadelphia and Pittsburgh—are rich in highly-motivated blacks. So is Mr McCain's focus on Pennsylvania just a sign of desperation?

Mr McCain has some solid things on his side. The Democrats' margin of victory has shrunk relentlessly from nine points in 1992 to four in 2000 to 2.5% in 2004. Pennsylvania's population is older than the American average, and more likely to be found in rural areas and small towns. Mr McCain hopes that he can turn out enough Republicans and conservatives in small town Pennsylvania—particularly in the grim middle of the state—to offset Mr Obama's advantage in the big cities.



Mr Obama has also had a lot of trouble connecting with working-class Pennsylvania. He lost the state to Hillary Clinton by nine points. He was ill at ease in the state's bars and bowling alleys. His problems in Pennsylvania inspired his famous remarks about "bitter" voters clinging to their guns and religion. Mr McCain hopes that these bitter voters will add the Republican Party to the list of things that they cling to.

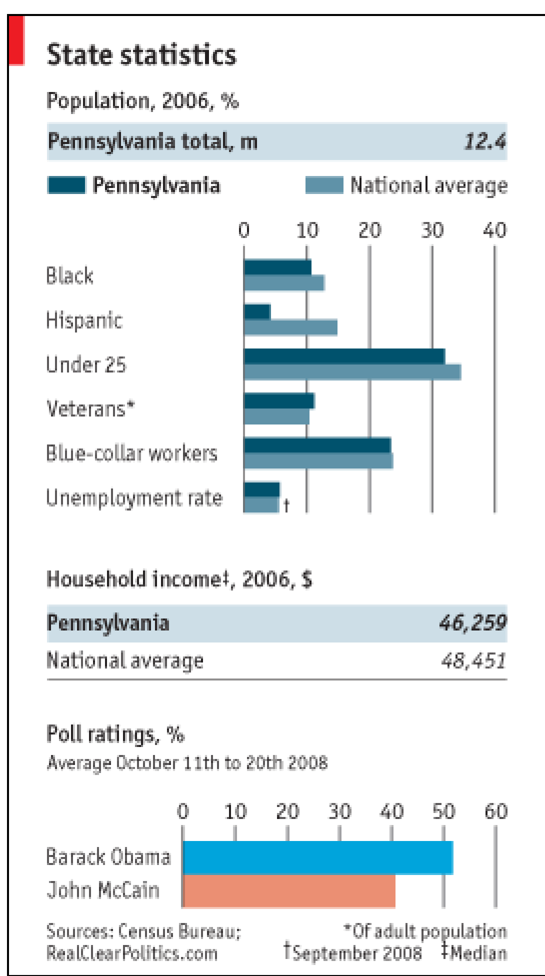
But the chances of an upset look slimmer by the day. The state's Democratic machine, which backed Mrs Clinton during the primary, is now in Obama overdrive. The governor, Ed Rendell, is popular and wily.

Bob Casey, the state's junior senator and a pro-life Catholic, is preaching the Obama religion to small-town voters. The Democrats also have a majority in both the state House of Representatives and the state's House delegation in Washington, DC.

Mr Obama has also invested a lot of resources in shoring up the state. Joe Biden, his running-mate, is a native of Scranton. The Obama campaign also scheduled prime-time speaking slots for both Mr Rendell and Mr Casey at their convention.

The long-drawn-out primary fight also helped Mr Obama. Mr McCain ignored the state during the Republican primary because he already had the nomination sewn up. Mr Obama spent 18 days there, fighting for every vote. The intense battle produced a surge in Democratic Party registrations: the Democrats now have an advantage over the Republicans of almost 1.2m compared with 500,000 in 2004. And the pro-Democratic trend seems to have continued since the primary: in Allegheny County, in the south-west, 28,000 new Democrats have registered to vote since then compared with 6,000 Republicans.

Mr McCain's response to the problems on Wall Street has also served him ill in the state. He was within a couple of points of Mr Obama before the crisis hit. But since then he has fallen ever further behind. Working-class voters who have traditionally fluctuated on economic issues (which push them to the left) and cultural issues (which push them to the right) are now firmly focused on the economy. "You have to earn respect in this state", says one Obama supporter, "particularly if you are a newcomer. Mr Obama earned respect in his handling of the economic crisis".



Mr Obama also has an overwhelming advantage with his ground game. The Obama campaign has not just been content to produce huge turnouts in the big cities. It is fighting for every vote. Mr Obama has 81 field offices across the state, many in places where Democrats have never competed before, compared with Mr McCain's three dozen. Mr Obama is also making clever use of affinity groups—getting nurses to organise meetings with other nurses and Catholics (a vital group in Pennsylvania, accounting for almost 25% of people) to organise meetings with other Catholics.

Consider Mr Biden's hometown. Scranton is full of the sort of white working-class voters who supported Mrs Clinton by huge margins during the primary and who Mr McCain now covets: the minority population is in the single digits and the telephone book is full of Irish, Italian and East European names. But the contrast between the ground operations of the two campaigns is stunning.

The McCain office only had a couple of people working the phones when *The Economist* visited. The young man who was in charge had no idea that Mr McCain was in the state that day. The Obama office, by contrast, was crammed to the brim and hyper-organised. There were plenty of older people sporting "Hillary sent me" badges as well as younger Obamaphiles. The walls were covered with charts telling people where they had to be and when. After dark, it was still buzzing with volunteers. The McCain office was closed.

Lexington

The rise of the Obamacons

Oct 23rd 2008
From The Economist print edition

A striking number of conservatives are planning to vote for Obama

Illustration by KAL



IN "W.", his biopic about his Yale classmate, Oliver Stone details Colin Powell's agonies during George Bush's first term. Throughout the film Mr Powell repeatedly raises doubts about the invasion of Iraq—and is repeatedly overruled by the ghoulish trio of Dick Cheney, Donald Rumsfeld and Karl Rove. In one of the final scenes, with his direst warnings proving correct, Mr Powell turns to Mr Cheney and delivers a heartfelt "Fuck you".

The real Colin Powell used more diplomatic language in endorsing Barack Obama on October 19th, but the impact was much the same. Mr Obama is a "transformational figure", he mildly said, and his old friend John McCain had erred in choosing a neophyte as a running-mate. But you would have to be naive not to see the endorsement as a verdict on the Bush years.

Mr Powell is now a four-star general in America's most surprising new army: the Obamacons. The army includes other big names such as Susan Eisenhower, Dwight's granddaughter, who introduced Mr Obama at the Democratic National Convention and Christopher Buckley, the son of the conservative icon William Buckley, who complains that he has not left the Republican Party: the Republican Party has left him. Chuck Hagel, a Republican senator from Nebraska and one-time bosom buddy of Mr McCain has also flirted heavily with the movement, though he has refrained from issuing an official endorsement.

The biggest brigade in the Obamacon army consists of libertarians, furious with Mr Bush's big-government conservatism, worried about his commitment to an open-ended "war on terror", and disgusted by his cavalier way with civil rights. There are two competing "libertarians for Obama" web sites. CaféPress is even offering a "libertarian for Obama" lawn sign for $19.95. Larry Hunter, who helped to devise Newt Gingrich's Contract with America in 1994, thinks that Mr Obama can free America from the grip of the "zombies" who now run the Republican Party.

But the army has many other brigades, too: repentant neocons such as Francis Fukuyama, legal scholars such as Douglas Kmiec, and conservative talk-show hosts such as Michael Smerconish. And it is picking up unexpected new recruits as the campaign approaches its denouement. Many disillusioned Republicans hoped that Mr McCain would provide a compass for a party that has lost its way, but now feel that the compass has gone haywire. Kenneth Adelman, who once described the invasion of Iraq as a "cakewalk", decided this week to vote for Mr Obama mainly because he regards Sarah Palin as "not close to being

acceptable in high office".

The rise of the Obamacons is more than a reaction against Mr Bush's remodelling of the Republican Party and Mr McCain's desperation: there were plenty of disillusioned Republicans in 2004 who did not warm to John Kerry. It is also a positive verdict on Mr Obama. For many conservatives, Mr Obama embodies qualities that their party has abandoned: pragmatism, competence and respect for the head rather than the heart. Mr Obama's calm and collected response to the turmoil on Wall Street contrasted sharply with Mr McCain's grandstanding.

Much of Mr Obama's rhetoric is strikingly conservative, even Reaganesque. He preaches the virtues of personal responsibility and family values, and practises them too. He talks in uplifting terms about the promise of American life. His story also appeals to conservatives: it holds the possibility of freeing America from its racial demons, proving that the country is a race-blind meritocracy and, in the process, bankrupting a race-grievance industry that has produced the likes of Jesse Jackson and Al Sharpton.

How much do these Obamacons matter? More than Mr McCain would like to think. The Obamacons are manifestations of a deeper turmoil in the Republican rank-and-file, as the old coalition of small-government activists, social conservatives and business Republicans falls apart. They also influence opinion. This is obvious in the case of Mr Powell: Mr Obama is making liberal use of his endorsement to refute the latest Republican criticism that he is a "socialist". But it is also true of lesser-known scribblers. At least 27 newspapers that backed Mr Bush in 2004 have endorsed Mr Obama.

Moreover, the revolt of the intellectuals is coinciding with a migration of culturally conservative voters—particularly white working-class voters—into Obamaland. Mr Obama is now level-pegging or leading among swing-groups such as Catholics and working-class whites. A recent *Washington Post*-ABC poll shows him winning 22% of self-described conservatives, a higher proportion than any Democratic nominee since 1980.

Don't blame the rats

The more tantalising question is whether the rise of the Obamacons signals a lasting political realignment. In 1980 the rise of the neocons—liberal intellectuals who abandoned a spineless Democratic Party—was reinforced by the birth of working class "Reagan Democrats". Is the Reagan revolution now going into reverse? There are reasons for scepticism. Will libertarians really stick with "Senator Government", as Mr McCain labelled Mr Obama in the best slip of the tongue of the campaign? Will economic conservatives cleave to a president who believes in "spreading the wealth around"?

Much depends on how Mr Obama governs if he wins, and how the Republicans behave if they lose. Mr Obama talks about creating an administration of all the talents. He promises to take the cultural anxieties of Reagan Democrats seriously. For their part, hard-core Republicans are handling their party's travails abysmally, retreating into elite-bashing populism and denouncing the Obamacons as "rats" who are deserting a sinking ship. If the Republican Party continues to think that the problem lies with the rats, rather than the seaworthiness of the ship, then the Obamacons are here to stay.

Argentina

Cristina's looking-glass world

Oct 23rd 2008 | BUENOS AIRES
From The Economist print edition

A plan to nationalise private-pension funds looks like a cunning but short-sighted government effort to stave off another debt default

Illustration by David Simonds



ACROSS the developed world, solvent governments have temporarily nationalised banks whose survival was in doubt. Argentina, which often resembles the rest of the world seen through a distorted mirror, likes to do things differently. There the private pension system, which has suffered investment losses but is otherwise sound, now faces permanent nationalisation by a government whose own solvency has been called into question. “The G8 countries are protecting their banks, and we’re protecting our workers and retirees,” declared President Cristina Fernández de Kirchner, as she announced a bill containing the measure on October 21st.

The immediate effect was to leave them less protected: the Buenos Aires stock-exchange index fell 24% in two days, and investors dumped Argentine bonds, sending their yield soaring to 28%. Many economists and opposition politicians fear that the government’s intention is to raid the pension funds to fill a widening fiscal hole. “A legalised robbery” was how *La Nación*, a newspaper, dubbed it in an editorial.

The private pension system was set up in 1994 by Carlos Menem, a conservative president. It was part of a wave of reform that saw many countries in Latin America set up private schemes, in which workers pay contributions into individual retirement accounts. This was a response to the lamentable record of the region’s state-run pension systems, whose pensions were often shrivelled by inflation or by government raids on their funds. Mr Menem’s scheme allowed workers to choose between staying with the state system or switching. By 2003 84% of workers with a pension scheme had chosen the new private funds. They have 9.5m accounts and assets of $30 billion. They are the largest investors in Argentina’s depleted capital markets. Their demise would make it far harder for local firms to raise money.

The private system, which now comprises ten funds whose managers include Britain’s HSBC and Spain’s BBVA, has had its problems. Its introduction carried a transitional cost for the government, as the flow of contributions to the state-run scheme fell. This was one of several factors behind Argentina’s financial collapse of 2001, in which the government defaulted on debts of $81 billion. The funds’ returns have been disappointing, partly because they charge hefty commissions but also because the state has required them to hold a lot of government bonds (these amount to 55% of their portfolios). In 2001, in a desperate effort to stave off debt default, Domingo Cavallo, the economy minister, forced them to swap bonds (and cash) for long-dated or low-yielding paper. Last year Néstor Kirchner, Ms Fernández’s

husband and predecessor as president, forced the funds to dump some of their foreign investments. He also allowed holders of individual accounts to switch back to the state system at no charge (1.2m did so).

Ideological hostility to the private funds played a part in Ms Fernández's decision to scrap rather than reform the scheme. Her husband reversed several of Mr Menem's privatisations. But fiscal need may have been a bigger motive. "It looks like they want to use the workers' money for non-pension spending," says Gregorio Badeni, a professor at the University of Buenos Aires. "The reason private pensions were instituted in the first place was to stop the government from doing that."

Ahead of last year's presidential election Mr Kirchner stepped up public spending, especially on public-sector wages and pensions. Now the government is strapped for cash. It has relied on taxes on farm exports. But the world price of soyabeans has fallen by 44% in three months, cutting tax revenues by $2.7 billion. And over the next two years $23 billion of public debt falls due.

Argentina has not been able to roll over this debt because investors' lack of trust in the government has led them to demand astronomical interest rates. The main foreign buyer of Argentine bonds recently has been Venezuela, but Hugo Chávez demands a hefty yield and anyway now has his own fiscal problems (see article). In an attempt to charm foreign investors in September Ms Fernández said she would pay off $7 billion owed to creditor governments, using the Central Bank's reserves. She has also said that she will "analyse" a plan to pay off those bondholders who refused the tough terms offered by Mr Kirchner in 2005, when he restructured the defaulted debt. But these moves have failed to reduce interest rates on Argentine debt.

By taking over the private pension system, Ms Fernández could solve her cashflow problem for the remaining three years of her term at a swoop. It would put assets worth 10% of GDP at the government's disposal, and allow it to channel an additional $400m a year of workers' contributions into public debt. The government could also force the pension system to roll over the 10% of public debt held by the private funds on terms of its own choosing. Of course, all this money belongs to Argentines, not to Ms Fernández. But under the bill, it would be administered by government officials, overseen by a congressional committee. They are likely to give priority to the short-term claims of the public finances at the expense of impoverishing Argentines and their children in the future.

Congress is indeed a possible obstacle to the government's pension grab. Most opposition parties say they will vote against the bill unless it contains safeguards against malfeasance. The president's majority is uncertain: earlier this year, lawmakers from her Peronist party helped to veto her plan to raise taxes on farmers. But the private pension funds are unpopular with the public.

If the law is passed, account holders will deluge the courts with lawsuits, as happened when bank deposits were frozen during the 2001 collapse. By proposing the nationalisation, Ms Fernández has further undermined faith in her government's solvency and in property rights. "Where is the state going to stop now?" asks Miguel Kiguel, a former finance official. "Today they're taking the pension funds. Who's next?"

Latin America and the United States

The more things change

Oct 23rd 2008
From The Economist print edition

The neighbours' tepid enthusiasm for Barack Obama

AFP



Adios, Señor Bush

OF THE two candidates in the American presidential election, it is John McCain who knows something about Latin America. Not only was he born in Panama, he also visited Colombia and Mexico in July. He thinks the United States should ratify a free-trade agreement with Colombia and, at least until it became politically toxic, wanted to reform immigration policy. Ask him who the United States' most important friends around the word are and he pretty quickly mentions Brazil.

And yet if they had a vote, Latin Americans, like Europeans, would cast it for Barack Obama—though without much enthusiasm. Preliminary data from the latest Latinobarómetro poll, taken in 18 countries over the past month and published exclusively by *The Economist*, show that 29% of respondents think an Obama victory would be better for their country, against only 8% favouring Mr McCain. Perhaps surprisingly, 30% say that it makes no difference who wins, while 31% claim ignorance. Enthusiasm for Mr Obama is particularly high in the Dominican Republic (52%), Costa Rica, Uruguay and Brazil (41%). In Brazil, six candidates in this month's municipal elections changed their names to include "Barack Obama" in them.

The poll suggests that support for Mr Obama is greater among better-educated Latin Americans. Marta Lagos, Latinobarómetro's director, says the relatively widespread indifference shows the extent to which the United States has lost influence in the region in recent years.

An adopted Texan with a Mexican sister-in-law, George Bush came to office promising to strengthen ties with the neighbours to the south. The terrorist attacks of September 2001 introduced new priorities. Latin Americans were hostile to the war in Iraq, perhaps because some countries in the region had suffered American-backed efforts at regime change in the past. Mr Bush was seen as doing little to help when Argentina's economy collapsed in 2001. His administration then seemed to endorse a failed coup attempt against Venezuela's leftist president, Hugo Chávez.

In Mr Bush's second term, American policy towards the region has been very different in tone. The administration has sought to work with allies such as Brazil, Mexico, and Chile. It has tried hard not to be provoked by Mr Chávez, and by other radical leftist governments. Mr Bush has talked about the need to fight poverty. Whoever wins next month is likely to adopt a broadly similar approach.

But several of the United States' foreign-policy concerns in Latin America—trade, migration, illegal drugs

and Cuba—are also domestic issues. Take trade. Mr McCain is a committed free-trader. Mr Obama has said he will seek to “renegotiate” the North American Free-Trade Agreement (NAFTA) with Canada and Mexico. He also opposes the trade agreement with Colombia, citing murders of trade unionists there (although these have fallen steeply, and their perpetrators increasingly face justice). This alarms Mexican officials and disappoints those of Colombia. But Mr Obama adopted this stance because voters worry about the loss of manufacturing jobs, and because it chimes with his union backers.

If Mr Obama wins, he may set up a general review of trade policy and of the safety net for those who lose their jobs. That might make it politically possible for him not to sour relations with the neighbours by trying to reopen NAFTA, reckons Michael Shifter of the Inter-American Dialogue, a think-tank in Washington, DC. He thinks that the Colombia trade agreement will eventually be approved.

Less separates the two candidates on migration. Both support stronger border control. Neither offers anything new on illegal drugs (both men voted for the Mérida Initiative, granting aid to Mexico, and both back Plan Colombia). There is a clearer difference on Cuba. Mr McCain is an enthusiastic supporter of the American economic embargo against the island. In a speech in Miami, Mr Obama promised to lift Mr Bush’s restrictions on family visits and remittances by Cuban-Americans, but not the embargo itself.

Mr Obama pledged to increase foreign aid to Latin America, but financial turmoil is likely to put paid to that. Unlike Mr McCain, he supports the tariff against Brazilian ethanol. Yet Brazil’s government would feel more comfortable with Mr Obama than it has with Mr Bush, according to one minister. That goes for many of the region’s left of centre governments.

Would an Obama victory serve to reduce anti-Americanism in the region? Ms Lagos reckons that it might, because expectations of change are so low. It would be harder for Mr Chávez to portray Mr Obama as “the devil”, as he did Mr Bush. But the issues that divide the United States from Mr Chávez and his friends are not about to disappear, says Mr Shifter.

Brazil

Licensed to scribble

Oct 23rd 2008 | SÃO PAULO
From The Economist print edition

An end to journalism's closed shop?

ONE of the many things that remained the same in Brazil when military rule went in 1985 was the need for journalists to obtain a diploma and register with the labour ministry. When the law stipulating this was introduced in 1967, it provided a useful way to prevent troublemakers from voicing their opinions. It has survived because Brazil is often slow to undo such anachronisms, but also because it suits the journalists' union to keep a closed shop.

Now the Supreme Court is considering whether to strike out the law. At the same time, the ministry of education is pondering whether any Brazilian with a university degree should be granted a diploma that would permit them to scribble (a requirement that would still exclude the president, Luiz Inácio Lula da Silva, for a start).

"The quality of journalism in Brazil would suffer if the rules are changed," asserts Celso Schröder of the National Federation of Journalists. That is questionable. Much of Brazil's journalism is good and robustly independent, particularly when compared with the media in Mexico or Argentina. But this has less to do with the diplomas that hacks wield than with the competitiveness of the newspaper and magazine market. Though there are only a few widely-available television channels, they too do a fairly good job of reporting what is going on to those who watch the news rather than read it.

The biggest flaw in the Brazilian media concerns the ownership of radio stations and provincial newspapers. According to Donos da Mídia, a monitoring group, 271 politicians (defined as state or federal legislators or mayors) are either directors or partners in media companies. Surprisingly, the two states with the highest incidence of politician-proprietors are Minas Gerais and São Paulo in the developed south-east. No diploma can guarantee reporting that is independent of these mini-Berlusconis.

Hazardous hypocrisy

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From The Economist print edition

A curious liking for asbestos

FOR more than a decade, workers in hazmat suits have been boring into the walls and ceilings of Canada's parliament buildings to remove tonnes of asbestos insulation. This tedious and expensive work is to protect the health of lawmakers and their staff: even limited exposure to asbestos can cause lung cancer or mesothelioma, a deadlier cancer. These risks have prompted most rich countries, and many poor ones, to ban all forms of asbestos.

But they have not stopped Canada from exporting large quantities of the mineral to developing countries, especially in Asia, nor discouraged the government from paying to promote its use abroad. This is "corporate welfare for corporate serial killers", says Pat Martin, a former asbestos miner who is one of the few members of parliament to denounce the hypocrisy.

Campaigners hope that it will end at a meeting in Rome, starting on October 27th, of the Rotterdam Convention, a registry compiled by the United Nations of hazardous substances which require "prior informed consent" before they can be exported from one country to another. Canada has lobbied vigorously to prevent chrysotile, or "white" asbestos—the only kind still mined—from being included.

The industry argues that this carries little risk of pleural mesothelioma, a cancer of the lungs' protective lining. It also claims that if chrysotile is used in high-density materials, in which the asbestos is bound together with concrete or resin, the risk of lung cancer is minimal. But medical experts, including the World Health Organisation, disagree. They say that in practice it is impossible to prevent carcinogenic dust being released when chrysotile asbestos is handled, and want it listed as hazardous under the convention.

At the convention's previous meeting in 2006 Canada led a select group of countries—including India, Iran, Kyrgyzstan, Peru and Ukraine—in blocking a listing. The reward for Canada lending its boy-scout reputation to this cause was that the other countries would "tolerate higher-cost Canadian producers" and thereby allow its asbestos industry to remain profitable, according to a ministerial briefing-note obtained by a researcher.

Fewer than a thousand Canadians still work in asbestos mines, down from 7,000 in the 1970s. The remaining active mines are in Quebec. The industry's labour battles, and role in the approval of workplace safety laws, have given it an almost sacred status in the province and made it politically untouchable. Even health officials are wary of criticising it, although mesothelioma rates in Quebec are among the highest in the world. "It's a very touchy question," says Louise de Guire of the province's public-health institute. "There's a certain pride in the industry, even if not many people survive off it any more."

Things may be about to change. This month two dozen public-health experts issued an open letter calling for chrysotile to be listed under the convention. This followed calls from Canada's main labour federation for an end to asbestos mining and exports. Comparing the asbestos industry to arms traders, the *Canadian Medical Association Journal* said the government was taking part in a "death-dealing charade" by arguing that chrysotile can be safely used in the developing world.

The political timing is propitious for a ban. Stephen Harper, the prime minister, has just won a second term for his Conservative minority government. He owes no favours to Quebec's voters, who gave him no extra seats, or to Jean Charest, the province's premier and a former ally, who railed against the federal government during the campaign.

Officials say they have yet to decide what position they will adopt at the Rome meeting. If they drop their opposition to chrysotile being listed as a hazardous material, that would be the first step towards banning

it, fears Clément Godbout, who heads the Chrysotile Institute, a government-funded lobby group formerly known as the Asbestos Institute. That, say campaigners, is precisely the point.



WORLD ASIA

China's housing market

What goes up

Oct 23rd 2008 | BEIJING
From The Economist print edition

The housing market provides some nasty shocks to China's new middle classes

EPA



HOMEOWNERS in a middle-class district in northern Beijing are angry. The developer of their block of flats has slashed the prices of new flats now on sale. China's housing market, barely existent a decade ago, is undergoing its first big downturn after years of boom. The earlier buyers want their money back.

For several years China's leaders have been trying gently to deflate a housing-market bubble pumped up by huge demand from a fast-growing middle class with few other investment opportunities. In the past few months their efforts have begun to pay off. But economic growth has also begun to slow, the stockmarket is far below last year's peak and worries are growing about the impact of the global financial crisis. Weaned in unremitting good times, China's fledgling middle class, whose support the Communist Party sees as crucial, is entering uncharted territory.

Dozens of homeowners at the Fuli Taoyuan complex in Beijing's Haidian district have been complaining to their compound's developer since May, soon after the prices of new apartments were first cut by more than 10%. They are now down to 9,000 yuan ($1,300) per square metre, compared with 15,000 yuan in February. Some have demanded compensation for the difference between the reduced rates and the amount they paid. Some have asked the developer to buy their flats back, accusing the company of deliberately concealing its plans to cut prices.

Numerous other property companies around China are similarly beleaguered. The Chinese press says that in September around 100 homeowners in the eastern city of Hangzhou stormed into the offices of Vanke, a big developer, to demand compensation for falling prices. In March a company in the southern city of Shenzhen (pictured above) caused a stir after it cut prices by 20%, by coughing up the difference to about 25 previous buyers of its property. Others have resisted giving cash, but have tried to calm homeowners by offering discounts on management services.

The official press has shown little sympathy for the homeowners' demands. Taming the housing market has long been a central-government objective. Even so, many local governments are now deeply worried about the downturn. By the second quarter of this year, prices were falling in more than a dozen big and medium-sized cities. Property-related activity makes up a considerable chunk of local governments' revenue and, as Yi Xianrong of the Chinese Academy of Social Sciences points out, helps to line officials' pockets.

In recent weeks 18 cities, including Hangzhou and Shanghai, have introduced measures to prop up the

market. These include cuts in transaction taxes and even subsidies for homebuyers. Hangzhou has made it easier for rural dwellers who buy homes in the city to obtain urban-residence certificates. These confer access to subsidised education and better health care than in the countryside. Shenzhen, where house-price falls have been among the country's biggest (see chart), has so far resisted the temptation to intervene. So has Beijing, where the number of residential properties sold during the weeklong national-day holiday earlier this month—usually a brisk period for sales—was down by 72% compared with the holiday in 2007.

For all the grumbling of homeowners wrong-footed by the market's plunge, the central government is still mindful that a large proportion of middle- and lower-income households have been complaining bitterly about the fast rise in house prices in recent years. This group has a bit of clout too. Since they came to power six years ago, the present bunch of China's top leaders have been trying to present themselves as more "pro-poor" than those in charge when the country launched its sweeping privatisation of urban housing in 1998 (a move that marked the birth of China's middle class).



Signals of where the central government wants the market to go remain mixed. On October 17th Wen Jiabao, the prime minister, presided over a meeting of the State Council, China's cabinet, which called for a reduction in property sales taxes. On October 22nd the government announced that the minimum down-payment on first homes would be reduced to 20% from 30%, stamp tax would be eliminated and mortgage rates cut. But there has been no promise yet to scrap more stringent requirements, introduced in September last year, for borrowing for a second home. These measures acted as a strong brake on the housing market.

The State Council called for the construction of government-subsidised housing to be stepped up. This could help stimulate economic growth, about which the government is showing signs of concern. On October 20th the National Bureau of Statistics said that GDP grew in the third quarter by 9%. This was lower than many had expected and the first time in four years a quarterly growth figure was in single digits. One Chinese newspaper said the government was considering the launch of a trillion-yuan fund to help build affordable homes. A bigger supply of cheap housing is hardly likely to boost prices.

Growing demand for homes in the cities, on the other hand, certainly will help. The government wants to move many tens of millions of rural residents into urban areas in the coming decade. Andy Rothman of CLSA, an investment-banking firm, argues in a research note that with household debt "almost non-existent" and state-owned banks ready to lend, buyers will return to the market as the dampening measures are eased. And to keep artificially depressing the housing market, he notes, would anger the middle-class homeowners the party has been cultivating: not a risk China's leaders are likely to take.

Chinese press controls

Eating their words

Oct 23rd 2008 | BEIJING
From The Economist print edition

On food safety, the Chinese press applies an odd precautionary principle

Illustration by Claudio Munoz



IT IS, declares China's foreign ministry, a "big step forward" in its handling of foreign journalists in the country. On October 17th a temporary relaxation of rules governing their activities, introduced for the Beijing Olympics in August, was made permanent. The Chinese press, however, has no such good news.

Until the Olympic reporting rules came into force in January last year, foreign journalists based in China needed government approval for any reporting trip outside their city of residence. Officials often insisted on tagging along. Many journalists would travel without permission, but local police often stopped them, seized their notebooks and expelled them from their areas.

The new freedoms have their limits. Permits are still needed to report in Tibet. And even since January 2007 the Foreign Correspondents' Club of China has logged 336 cases of official interference in foreign journalists' work. But their travails are trivial compared with those endured by Chinese journalists, who, unlike them, have to cope with a barrage of directives issued by the Communist Party's Propaganda Department.

This helps explain why the Chinese media were slow to reveal the dangers of contaminated milk powder sold in China (and to a far lesser extent, exported) in the months leading up to the Olympics. The powder made tens of thousands of children ill and killed at least four. Chinese journalists knew about the problem, if not the full extent of it, weeks before it became public in September. But officials and dairy executives, apparently worried about spoiling the mood at the games (not to mention their reputations), did not want news to spread.

Journalists had to be mindful of long-standing, but mostly secret, orders from the Propaganda Department about reporting food-safety issues. *The Economist* has seen a directive issued by a provincial propaganda bureau. Circulated in January 2005, it bans the media from naming any suspect food product until a "clear verdict" has been reached by the authorities. There are to be no exposés of safety problems concerning famous Chinese food brands or food products for export without official approval. For imported food, approval must come from Beijing. If it causes poisoning, only Xinhua, the official news agency, may break the news and even its reports must be approved by the Propaganda Department and the foreign ministry.

Fu Jianfeng, an editor at *Southern Weekend* newspaper in Guangdong province, wrote on his blog that one of his reporters heard about the milk story in July. But the newspaper could not investigate, he said, because of demands for "harmony" before the games. The blog entry has since been deleted.



South Korea

Second time around

Oct 23rd 2008 | SEOUL
From The Economist print edition

Shock, denial, anger and a massive bail-out for good measure

OF ALL the Asian countries worst ravaged by the regional financial turmoil of 1997-98, South Korea has come closest in recent weeks to seeing history repeat itself—not as farce, but as renewed financial tragedy. As its stockmarket has slid downhill and the currency, the won, has fallen by nearly 30% this year, the government has been telling all-comers that the economy is sound and the banks liquid and solvent. Its officials have blamed their troubles on the ignorant or malicious refusal of foreign analysts to believe them.



Yet on October 19th the government announced a $130 billion rescue for Asia's fourth-largest economy. Of this, $100 billion is in the form of guarantees for foreign-currency debts. Another $30 billion—about one-eighth of the country's foreign-exchange reserves—was to be available to banks suffering a drought of dollars. It followed this up two days later with a promise to spend 12 trillion won ($9.2 billion) to help the building industry—for example by refinancing debts and buying unsold houses. The president, Lee Myung-bak, described the overall economic situations as "more serious" than in 1997, because of the global sweep of the crisis. The government had already appealed to the grass-roots patriotism that helped South Korea through the late 1990s: cutting back on energy bills; buying local products; and surrendering any dollars left over from overseas jaunts.

Mr Lee and his officials, however, are quite right that the economy is on a much sounder footing than in 1997. Banks are better capitalised, big companies less indebted and reserves of foreign exchange bigger than all but five other countries'. The economy has been growing solidly for a decade. Even after the recent buffeting, analysts still expect GDP to grow by more than 4% this year, and by 2.5-3.5% in 2009. That is nowhere near the 7% growth President Lee promised at his inauguration in February, but in the current doom-laden climate it looks positively robust.

One reason for this relative optimism is the shipbuilding industry, one of South Korea's great success stories. Yet it is also one cause of the financial stresses. There has been a sharp rise in foreign debt. More than one-tenth of the rise is in down-payments for ships still being built, which appear in the accounts as trade credits. And around half of the increase in short-term debt comes from banks hedging their exposure to purchases of shipbuilders' dollar receivables in the forward market.

That helps explain the way in which the global credit crunch first made itself felt in South Korea—in a shortage of dollars for the banks. Moody's, a credit-rating agency, estimates that South Korea's banks rely on foreign sources for 12% of their funding. As inter-bank markets worldwide clammed up, they began to look vulnerable. Standard & Poor's, another rating agency, this month put seven of them on a "watch-list", because of the pressure they faced.

The won itself has been battered as foreign investors have fled Korean shares and bonds. Its decline also reflects the current account's fall into deficit as the cost of South Korea's oil and other commodity imports soared earlier this year. The government rescue stemmed the tumble in the won and the stockmarket only briefly. As elsewhere, financial catastrophe seemed to have been averted. But also as elsewhere, traders knew that the impact of the market turmoil on the rest of the economy was only beginning to be felt.

Thailand

Thaksin come home

Oct 23rd 2008 | BANGKOK
From The Economist print edition

Nothing is forgiven; a prison cell awaits

EPA



Protesters Against Democracy

FOES of Thaksin Shinawatra cheered when, on October 21st, the Supreme Court in Bangkok sentenced the former prime minister to two years' jail over his wife's purchase of land from a state agency in 2003. It was the first conviction against Mr Thaksin in the various corruption cases filed since the 2006 military coup, although his wife was sentenced to three years' jail for tax evasion in July.

This week's verdict boosted the People's Alliance for Democracy (PAD), which is seeking the downfall of the pro-Thaksin government elected last December and led by Somchai Wongsawat, Mr Thaksin's brother-in-law. The PAD, supported by Thailand's royalist establishment, has been camped out in the grounds of Government House since August, with little effort being made to dislodge it.

However, Mr Thaksin and his wife, Potjaman, will not be enjoying the hospitality of the Thai prison service just yet—or perhaps ever. The couple have been exiled in London since the Supreme Court let them leave Thailand in August to attend the Olympics in Beijing, whereupon they skipped bail. This raised suspicions that the former prime minister, who remains highly popular outside Bangkok, was set free to resolve the country's three-year political conflict. But the strife has continued. Earlier this month two people died when police and protesters clashed in Bangkok.

Prosecutors will seek Mr Thaksin's extradition but their chances of success are slender. Britain's courts would first have to be satisfied that he had committed a crime under both British and Thai law. His wife put in the highest of three sealed bids for the piece of land. Mr Thaksin was convicted only of breaching an anti-corruption law that bans officials' spouses from doing business with state agencies—and only by a 5-4 majority among the nine judges. Oddly, his wife was not convicted.

Britain also bars extradition if the defendant's trial back home might be politically prejudiced, as Mr Thaksin is already claiming—all he would have to do is raise some reasonable doubts. The Thai prosecutors and courts do seem to be fast-tracking cases against him and his allies while soft-pedalling on allegations against his foes. Treason charges against the PAD's leaders were softened, and they were bailed and continued occupying Government House, to the amazement of foreign diplomats and businessmen. Ironically, one case that raises questions about the courts' susceptibility to pressure saw Mr Thaksin, then prime minister, cleared in 2001 of concealing his assets.

The conflict drags on with no end in sight. The PAD is holding street rallies against alleged police brutality. Militant Thaksinites talk of attacking Government House to drag the PAD out, and of petrol-bombing the army if it stages another coup. The army chief, General Anupong Paochinda, said on television that Mr Somchai should resign as prime minister but Mr Somchai is, so far, staying.

India and Sri Lanka

Big brother is watching you

Oct 23rd 2008 | COLOMBO
From The Economist print edition

Renewed Indian interest in their country worries many Sri Lankans



FROM shanty houses to parliament, Sri Lankans are transfixed by one topic: India's impact on the government's war with the rebel Liberation Tigers of Tamil Eelam. This follows protests in the Tamil-majority Indian state of Tamil Nadu, where there has always been sympathy for fellow Tamils in Sri Lanka. Tamil Nadu's ruling party, the Dravida Munnetra Kazhagam (DMK), is part of the coalition government in Delhi, led by Manmohan Singh. Nineteen DMK lawmakers have threatened to resign if the government does not persuade Sri Lanka to declare a truce by October 29th. The DMK accuses Sri Lanka of a "genocide" of Tamil civilians trapped in the rebel areas of the Wanni, where fierce fighting is causing daily casualties on both sides.

The pressure from an important coalition partner has forced Mr Singh's government to act. In a phone conversation on October 18th Mr Singh urged Sri Lanka's president, Mahinda Rajapaksa, to start a process towards a negotiated political settlement. This sort of thing makes Sri Lankans nervous. They recall 1987, four years into the civil war, when an Indian peacekeeping force was sent to Sri Lanka. It was much resented by many members of the island's Sinhalese majority, and had disastrous consequences. The Tigers, who assassinated Rajiv Gandhi, a former Indian prime minister, in 1991, are banned in India. But as representatives of a minority seen as suffering discrimination, they still enjoy some support in Tamil Nadu. Another direct intervention in Sri Lanka is not on the cards. But India is the regional superpower and hard to ignore.

Sri Lankans are now even more preoccupied with India's role than with the fighting in the north. Sri Lankan soldiers are battling torrential downpours as well as the Tigers, outnumbered but resilient. The army is closing in on the Tigers' stronghold of Kilinochchi—which it has said it will capture by the end of the year.

India has dominated headlines in Sri Lanka's press. Influential Buddhist monks have urged it to keep out of Sri Lankan affairs. Questions have been raised in parliament. In response to the frenzy, President Rajapaksa summoned media bosses on October 21st to tell them that India had not asked his government to halt the war. The Rajapaksa government attributes the furore in Tamil Nadu to coalition politics and electioneering, ahead of the general election due in India by next May.

A senior presidential aide admits to concerns about the "rumblings" in Tamil Nadu. But he insists the Indian government understands Sri Lanka's fight against "terrorism" and will be satisfied so long as Sri Lanka "doesn't discriminate against the Tamils and gives them food and humanitarian assistance." That, however, may be underestimating the concern felt in India and elsewhere: not just at the humanitarian

crisis in the Wanni, but also at the apparent lack in the Sri Lankan government of any will to pursue a political settlement acceptable to most of its Tamil minority.

Pakistan

The last resort

Oct 23rd 2008 | LAHORE
From The Economist print edition

As its friends make their excuses, Pakistan turns to an old bogey



A NUCLEAR-ARMED front-line state in the "war on terror", Pakistan faces economic meltdown. On October 22nd the head of the IMF, Dominique Strauss-Kahn, said discussions would begin within the next few days on emergency financial support. How much was still to be determined. Pakistan needs a lot, urgently.

The economy is close to freefall. Inflation is running at about 30%. The rupee has devalued by about 25% in just three months. The fiscal deficit is a whopping 10% of GDP. Foreign-exchange reserves cover just six weeks of imports. A $500m Eurobond matures next February, but the market has already decided it is junk. The country needs at least $3 billion in short order, and a further $10 billion over the next two years to plug a balance-of-payments gap. Without it, default abroad might well coincide with political anarchy at home.

Pakistan's new president, Asif Zardari, has made desperate begging trips to Saudi Arabia, America and China. To no avail. The Saudis are dragging their feet on a Pakistani request for $5.9 billion-worth of finance in the form of deferred oil payments. The Chinese seem to have done their due diligence and concluded that they cannot blithely advance billions to an increasingly dysfunctional state.

America is distracted by its own financial crisis and an impending change of administration. A bill yet to be passed by Congress links economic assistance of up to $1.5 billion a year for ten years to progress on the war against Islamist extremists in the tribal areas and Afghanistan. Richard Boucher, the assistant secretary of state for South Asia, visited Pakistan this week, but said there was no prospect of American cash in advance. Mr Zardari is now scheduled to make another trip to Saudi Arabia in early November to entreat the Kingdom to bail out its old friend.

But Plan B is already swinging into action. Reluctantly, Pakistan has had to turn to the IMF again. Former prime ministers Nawaz Sharif and Benazir Bhutto, as well as Pervez Musharraf, who ruled from 1999 until this year, all had to clutch IMF lifelines when they took office. Mr Sharif and Miss Bhutto failed to abide by the programmes and brought the economy to the brink of default. General Musharraf tightened belts in the early years of his regime but ditched the IMF when cash inflows began to gush and the economy started to grow at an annual rate of over 6.5%.

That initial talks with the IMF took place not in Pakistan but in Dubai is telling. When an IMF delegation visited Pakistan in September, terrorists bombed the Marriott hotel in Islamabad, razing it to the ground. There could be no clearer demonstration of how winning the fight with the terrorists is essential for Pakistan's own economic and political health. But there is no consensus among the country's most senior soldiers and politicians on how to conduct the war. Differences were widened rather than narrowed by a closed-door briefing by the army to parliament this month, and this week parliament passed a resolution calling for dialogue with the extremists to be made the priority.

IMF support is expected to come with austere strings attached. Defence and development expenditure may be among the casualties. Neither the army nor the general public will be happy.

Kashmir's environment

How green was my valley?

Oct 23rd 2008 | LIDDER VALLEY, KASHMIR
From The Economist print edition

Climate change will only intensify problems in Kashmir

Get article background

AFTER a hard climb up the eastern flank of the Kolahoi glacier, Ghulam Jeelani, a geo-hydrologist from the University of Kashmir, catches his breath. This is the Kashmir valley's only year-round source of water. But it is melting at an alarming rate. The glacier is a dirty brown colour, wrinkled with crevasses. It looks more like an enormous mudslide than a frozen reservoir of fresh water. Mr Jeelani says that the glacier is in "ablation"—shrinking through melting. If present trends, which are blamed on climate change, continue, he concludes with a shrug, "In ten years there will be no Kolahoi glacier."

This threatens the livelihoods of millions, and the Kashmir valley's reputation as one of the world's most beautiful places, made ugly only by decades of human conflict. The region, disputed by India and Pakistan, is riven by a bloody insurgency. The reopening this week of lorry trade across the "line of control" dividing Indian- and Pakistani-controlled Kashmir was a rare moment of optimism. It followed months of anti-Indian protests that have reinvigorated the valley's secessionists.

The political tensions in Kashmir help explain why no one seems to have paid the alarming shrinkage of the Kolahoi glacier much attention, until now. According to villagers in nearby Aru, in 1985 the glacier's snout stretched half a mile (800 metres) further down the valley. The traces are still there: a dark tidemark on the valley's lower slopes, where trees and plants have not yet rooted. Unfortunately, there is a dearth of reliable scientific data on the region. Kolahoi lies just a few miles from the line of control. These densely forested mountains and valleys are an infiltration route for fighters sneaking over from Pakistan. Until recently it had not been safe to establish regular monitoring.

But Kolahoi's melting has profound implications for the valley. The glacier feeds the Jhelum river, which drains into the glorious Dal lake in Srinagar, and makes the valley so fertile. With its abundant rice, wheat and corn, its prized apple orchards and fields of saffron, the valley is a stark contrast to neighbouring Ladakh, a moonscape of barren mountains and high-altitude desert.

This, of course, is one reason the valley has been so bitterly contested. But its natural fecundity depends on water, and the water supply depends on glaciers such as Kolahoi. After the snow melts in May and June, the glaciers are the only source of water. If they disappear, says Mr Jeelani, Kashmir, long a water-rich area, could become one of "water stress".

Syed Hasnain, of The Energy and Resources Institute (TERI), the Delhi-based development think-tank that arranged this expedition, accuses the government of being less interested in environmental problems than in playing politics with Pakistan. But unless both governments set politics aside, an environmental disaster looms. TERI plans to include Kolahoi in an index of benchmark glaciers that span the Himalayas, part of an overdue attempt to monitor the rate of glacial decline in the range. That decline threatens, all too soon, to visit another sort of curse on a valley famously likened to paradise.



Water in Australia

The dry last ditch

Oct 23rd 2008 | BOURKE, NEW SOUTH WALES
From The Economist print edition

A controversial plan to save Australia's largest river system



AFTER 17 years, Tony and Michelle McManus are preparing for their last sheep-shearing season on Toorale, a sprawling outback property near Bourke in western New South Wales (NSW). By Christmas, Toorale's 30,000 sheep, 1,200 cattle and irrigation machinery will all be sold, ending a way of life on the ranch begun by the region's European pioneers in the 1870s. Last month Australia's federal and NSW state governments bought Toorale for almost A$24m ($17m), not to run it as a farm but to take control of a commodity that now seems more precious than the food and fibre it produces: water.

The sale of Toorale is the biggest of its kind in a plan by the federal Labor government, under Kevin Rudd, to buy water entitlements from farmers in Queensland and northern NSW. The water-buyback scheme, as it is known, is a last-ditch bid to save Australia 's biggest river system, the Murray River and its main tributary, the Darling (see map). Both are suffering from the worst drought in a century, and decades of prolific farm irrigation.

Toorale's 91,000 hectares (240,000 acres) straddle plains where the Warrego, a small river draining central Queensland, meets the Darling. Samuel McCaughey, a former owner, built a magnificent homestead there in the 1880s, when everything arrived on paddle steamers from the coast 1,000km (600 miles) away. It's a crumbling ruin now. But the elaborate system of levees he devised to store water from the Warrego, and insulate the property from drought, still operates.

Clyde Agriculture, the company for which the McManus family has managed Toorale since 1991, says the sale was prompted partly by this old system's inefficiency: in baking outback summers, in territory that supports just one sheep for every four hectares, about two metres of the stored water can be sucked into the sky each year from evaporation. The federal government plans to send back into the rivers all 14 billion litres that Toorale is entitled to extract from the Darling and Warrego each year.

Most controversy springs from the scheme's second strand: the NSW government's plan to take over Toorale's land for a national park. Bourke's residents recently rallied to protest at the loss of what some say is the region's most productive property. Drought, tougher water rules and falling wool prices have helped to cut the district's population by a quarter in just six years.

Bourke's local council reckons Toorale's business from its crop and grazing enterprises has been worth almost A$5m to the town each year. Its loss, it says, will shrink the town's economy by 10%. The council wants the state and federal governments to keep at least some animal grazing on Toorale to protect local

jobs, especially among indigenous people, who comprise 30% of Bourke's population (compared with 2% for Australia as a whole).

On a national scale, the battle between keeping Toorale's land and water in the market, or devoting them to the environment, could set a standard for changing the way outback lands are used, almost 150 years after white settlers turned sheep and cattle loose on them. Penny Wong, the federal minister for climate change and water, admits that little, if any, of Toorale' s water will reach the Murray's depleted mouth 1,000km south. But the Wentworth Group, a batch of water experts, gives her credit for trying to revive flows. It foresees an "unfolding environmental disaster" if water consumption in the Murray-Darling system is not cut by up to 53%. Peter Cosier, the group's convener, says: "We've reached a point where the water-buyback scheme is the only game left in town."

Saudi Arabia

The struggle against al-Qaeda

Oct 23rd 2008 | CAIRO
From The Economist print edition

The rulers of the Arab world's most conservative monarchy are taking the war to al-Qaeda—and may be succeeding

eyevine



THE Saudi kingdom has long been a fountainhead of jihadist radicalism, with martyrdom-seekers going on one-way tickets to such places as Chechnya, Iraq and the Twin Towers in America. At first rather complacent about Islamist terror, the Saudi rulers rumbled into active opposition only after their own cities came under fire, starting with a series of bombings in their capital, Riyadh, in May 2003. Now, in a move that suggests growing confidence in thwarting jihadist violence, Saudi courts have begun procedures to try 991 prisoners held on terrorism charges, in the most sweeping legal action yet taken in the global campaign against the extremists.

Aside from its scale, the mass prosecution is notable because the trials will take place under Islamic law before a panel of judges who are, like all those in the arch-conservative kingdom, schooled in the strict Wahhabist interpretation that has helped to inspire the ideology of groups such as al-Qaeda itself. Saudi officials are quick to assert that *sharia* sentences should therefore carry greater legitimacy than those handed down by the military tribunals favoured by other countries, which many Muslims, and not just jihadist sympathisers, dismiss as suspect.

Countering criticism of their archaic and often arbitrary legal system, Saudi officials insist that the trials will be transparent, with separate charges for cases of criminal violence, incitement, or financing of terrorist activity. The accused are likely to include not only active members of al-Qaeda, which carried out some 30 attacks in the kingdom between 2003 and 2006, costing the lives of 90 civilians and 74 policemen, but also of prominent sheikhs whose sermons justified the violence.

The trials are meant to mark the culminating phase in a unique and so far successful Saudi effort to uproot the most violent strains of radicalism. Unlike countries that have relied strictly on security forces to counter the threat, the kingdom chose a multi-pronged approach involving public awareness campaigns, legal and educational reforms and religious counselling.

State television has aired extensive testimony from “repentant” jihadists as well as from scholars challenging the textual basis of jihadist beliefs. A campaign in prisons has targeted more than 3,000 jihadist detainees for counselling, with sweeteners such as housing loans and financial support for their families as well as religious re-education (pictured above). Saudi authorities say that some 1,500 radicals have been rehabilitated and freed, with only a tiny fraction subsequently reverting to jihadist ways. A separate programme has sought to combat jihadist ideas on the internet, by hiring moderate religious

scholars to engage in debate on extremist chat sites. New laws have made incitement to terrorism over the internet a crime punishable by up to ten years in prison.

In any event, the kingdom remains oppressively conservative. As often as not, state-anointed scholars attack the radicals not on the grounds that bigotry and killing are wicked but because their *jihad* makes Islam look bad. Yet the fact is that there has been no big terrorist incident in Saudi Arabia since February 2006, when an al-Qaeda cell mounted a botched attack on an oil-processing facility at Abqaiq, near Saudi Arabia's east coast. Moreover, the volume of Saudi volunteers for *jihad* in such places as Iraq, Afghanistan and Lebanon appears to have markedly shrunk.

In fact, apart from the increasing boldness of their nominal allies, the Taliban, in Afghanistan, al-Qaeda does not appear to be faring well. Affiliate groups in such lawless places as Yemen, Algeria and Mauritania have launched recent attacks, such as an assault on the American embassy in Sana'a, Yemen's capital, last month, that killed 16 people while failing to breach the compound. But the fading of Iraq as a terrorist paradise and the increasing effectiveness of policing elsewhere have produced a more hostile global environment for jihadist radicals.

A clear sign of this was the sudden disappearance last month, on the anniversary of the September 11th attacks on America, of three of the four best-known radical websites that carry publicity releases and chat forums for al-Qaeda. Such sites, which are carefully monitored by intelligence agencies, have experienced interruptions before, but this is the first time that several have remained out of action for long. The lone surviving site, al-Hesbah, is thought by some experts to have been infiltrated by the Saudis, so as to keep tabs on campaigners elsewhere.

Zambia

The outsider versus the cobra

Oct 23rd 2008 | LUSAKA
From The Economist print edition

Copper-rich Zambia faces uncertainty as it chooses a new president

Reuters



King Cobra poised to bite

FOLLOWING the untimely death of President Levy Mwanawasa in August, Zambians must vote for a new leader on October 30th, just two years after their last presidential election. Four candidates are in the running. But the real contest is between Rupiah Banda, the vice-president who has acted as caretaker since Mr Mwanawasa's death, and Michael Sata, a fiery populist who was defeated in 2006.

Zambia, a leading copper producer, has been one of southern Africa's most stable countries. In 1991 its people voted out Kenneth Kaunda, who had run the show since independence in 1964, along with his ruling party. His successor, Frederick Chiluba, stepped down in 2002 after his own party had got fed up with him.

Bordered by troubled neighbours, such as Congo and Zimbabwe, Zambia has avoided violence or coups, even though copper riches were squandered after independence and most people are still dirt-poor. But the poll is a big test. Mr Sata, who claims the last election was stolen from him, has said he will not accept defeat. The ruling Movement for Multiparty Democracy (MMD), in power for the past 17 years, may be tempted to stack the decks in its favour. Can Zambians maintain their tradition of changing leaders peacefully?

The opposition is worried about rigging. Because the election was unexpected, the European Union has sent only a skeletal observer team. But the electoral commission's chairman is a respected judge. This time, results will be posted outside each polling station, making it harder to fiddle results at the centre. More local observers will be on hand than before. But close or contested results may stir up Mr Sata's people, who feel his time has come. A former MMD stalwart who broke ranks in 2001 to create his Patriotic Front, Mr Sata appealed for calm after his disputed defeat in 2006. He may not do the same if he feels victory is being stolen again.

Mr Banda, a former diplomat and minister whom Mr Mwanawasa plucked out of retirement in 2006, says he will follow in his predecessor's footsteps. But he may lack the authority to push for unpopular reforms and steer a divided party. He faced more than a dozen rivals for the ruling party's nomination. He is something of an outsider in the MMD; until quite recently, he was still a member of Mr Kaunda's old party. He has also embraced several people whom Mr Mwanawasa had cast aside on suspicion of dishonesty. It is not clear whether he would keep these questionable new friends after the election.

With the friendly bias of the state media and easier access to election funds, the incumbent has a head start. It is a one-round affair, even if no one gets more than 50%. Mr Banda is a slight favourite. But King Cobra, as Mr Sata is known, cannot be written off.

Unpredictable populist

He is popular in the capital, Lusaka, and in the Copperbelt, the economy's power-house. Many voters want change. Mr Sata draws big crowds at his entertaining rallies. This time he has put more energy into campaigning in rural areas, still the MMD's base, so that is where the election may be decided.

If Mr Sata won, it is unclear what he would do. Parliament will still be controlled by his rivals, the MMD. He tends to tell people what they want to hear, with promises of more jobs, free housing and lower

taxes. In 2006 he fuelled a growing anti-Chinese mood, threatening to cut ties with China, a leading trading partner and investor in Zambia, and to expel foreign traders. Since then he has changed his mind; foreign companies should merely respect labour laws and get no better treatment than local ones. At a campaign rally he was reported to have said he would force foreign investors to have local partners, but his officials deny this is his plan. Critics say he is an autocrat; his party has never had a congress to elect its leaders. His fans say he is a man of action who gets things done.

Whoever he is, Zambia's next president, who will be in charge only for the three years left in Mr Mwanawasa's term, may be boxed in. Rising food and petrol prices have pushed up inflation. Zambia relies less on foreign generosity than a few years ago, but a big chunk of its budget is still funded abroad; the tap would soon run dry if economic policy became populist. The economy is more diverse than it was but still relies on copper, whose price has slumped by around 40% since early September. Cash-strapped foreign investors are likely to take a dimmer view of riskier emerging markets such as Zambia, despite its quite perky performance of the past few years. Zambians may have to tighten their belts, no matter who wins.

Kenya

Spread the blame

Oct 23rd 2008 | NAIROBI
From The Economist print edition

Politicians, the police and the electoral commission are all being pilloried

TWO reports examining the violence that ravaged Kenya early this year after a disputed election have challenged the leaders on both sides of the political divide to clean up their act and even to let some of their biggest figures go before a tribunal for their alleged part in fomenting the strife. If the recommendations are put into practice, the culture of impunity that has protected Kenya's leaders for many years may be weakened. But there are also fears that delving into past violence may reopen barely healed wounds and undermine the fragile government of national unity that has run the country since April.

The first report, chaired by a South African judge, Johann Kriegler, focuses on the actual election—and lambasts the electoral commission for massive bungling. It makes clear that there were numerous instances of vote-rigging but does not pronounce on who should have been declared the winner. Most independent observers reckon that the opposition, led by Raila Odinga, who is now the prime minister, was cheated of victory—perhaps a narrow one—by a cabal surrounding President Mwai Kibaki, which bullied the commission into accepting a falsified result. Diplomats from the European Union, the United States and Japan, which have provided vast amounts of aid over the years, have pushed for a new electoral commission. The government reacted to this suggestion with predictable outrage. But the diplomats say that, far from treating Kenya with colonial disdain as the government suggests, they are merely reflecting the views of ordinary Kenyans who have lost confidence in the people who ran the election.

The second (quite separate) report is more controversial. Chaired by a Kenyan judge, Philip Waki, it tries to get to the causes of the violence and to finger its main perpetrators. At the report's presentation, Mr Waki handed a sealed envelope to Kofi Annan, a former secretary-general of the UN who mediated after the election and managed to bring a unity government together. The letter contains the names, so far unpublished, of ministers, members of parliament and businessmen accused of inciting violence and arming militias. Many names are listed in an earlier report published by Human Rights Watch, a New York-based monitoring group, and include several leading politicians, including some who are close to Mr Kibaki and to Mr Odinga. Mr Waki recommends that if the government fails to put the accused before a special tribunal to be set up within 60 days, the envelope should be passed to the International Criminal Court at The Hague with a view to prosecution.

Mr Waki's investigative team met victims across the country and quoted from previously classified daily reports of Kenya's National Security Intelligence Service (NSIS). President Kibaki's government, according to the Waki report, had "lost its legitimacy" and was "not seen as dispassionate". It used state security forces and criminal gangs to target opposition supporters. For their part, opposition leaders in the ethnically mixed Rift Valley, where much of the violence occurred, recruited thousands of armed men from the Kalenjin group to kill and clear out Kikuyus, who had overwhelmingly backed their ethnic kinsman, Mr Kibaki, in the election.

The 500-page report has some revealing and controversial details. It cites, for instance, an NSIS finding that a worker at a bullet factory in Eldoret had trained Kalenjin youths in guerrilla tactics. It also supports longstanding claims by human-rights groups and others that some of President Kibaki's aides had met, at State House, leaders of the Mungiki, an outlawed Kikuyu sect with a history of extortion and a penchant for beheading its enemies. As a result, the Mungiki helped co-ordinate the killing of Luos and Kalenjins in the towns of Naivasha and Nakuru, where the population is mixed.

The report also damns Kenya's police, which is said to have lacked organisation and leadership—and to have taken part in the killing. At least 405 of the 1,103 documented victims of the violence (several hundred more are unaccounted for) were shot dead by the police, most of them in the back; the majority were Luos who had supported Mr Odinga and had run riot in their homeland in western Kenya, where outrage at what they deemed a rigged election was fiercest. The report's emphasis on police failure has

raised suspicion that the police commissioner, Major-General Hussein Ali, may take the rap, while politicians and other security services get off comparatively lightly.

Meanwhile, Messrs Kibaki and Odinga have been winning plaudits for keeping the peace. Mr Kibaki says Kenyans should forget the past and look to the future. Mr Annan, however, has urged the government to set up the special tribunal, as suggested by Mr Waki, as soon as possible; forgetting, he insists, would not help tackle the regrettable culture of impunity.

Would a tribunal be able to bring some of Kenya’s “big men” to justice? Some of those who are thought to be listed in the sealed envelope have keenly endorsed the idea of a tribunal. They are confident, it seems, that it would have no teeth.

Nigeria's president

Please hurry up

Oct 23rd 2008 | LAGOS
From The Economist print edition

People are worried about Umaru Yar'Adua's slow pace of government

Reuters



AS GOVERNOR of a sparsely populated state in northern Nigeria, President Umaru Yar'Adua was known fondly as "the silent achiever". But a year-and-a-half into his first term as his country's president, more and more people are muttering that his unhurried style is failing to move the machinery of Africa's biggest and most boisterous nation. Nowadays he has a new nickname, taken from Nigeria's notorious traffic jams: "Baba Go-Slow".

Many Nigerians are complaining that their soft-spoken president has failed to fulfil his inaugural promises, for instance to improve the energy sector and to end violence in the oil-rich Delta region, which is losing the country billions of dollars of oil revenue. And worries about his own health are creating a mood of uncertainty.

"Initially I thought he was being deliberate—he likes to think before he acts," says a frustrated former government minister who lost out when Mr Yar'Adua came to office. "But now I think he's just out of his depth. He's overwhelmed. Nothing is going to be achieved."

Under Mr Yar'Adua, the Economic and Financial Crimes Commission (EFCC), an anti-corruption body, has lost its bite. Civil strife in the Delta has worsened. Nationwide electricity cuts are as frequent as ever. Worries about his kidney ailment have exacerbated things; northern power-brokers seem more concerned to retain power in the event of the president's demise than to get Nigeria back on its feet.

Before he was unexpectedly chosen to succeed Olusegun Obasanjo, Mr Yar'Adua, a former chemistry teacher, was a little-known governor of the remote northern state of Katsina. There he earned a name for quiet efficiency, spending eight years deliberating and consulting as he steadily invested in development. On the sleepy sun-baked streets of Katsina, his reputation remains high. "He seeks many viewpoints before making a decision," says Mustapha Inuwa, who held several senior posts in Katsina under Mr Yar'Adua. "That's why it may take him a little time before he takes a position on an issue. But when he does take his stand, you find he rarely makes a mistake."

So far, as president, there have been no big decisions, so no big mistakes. He rarely pontificates in the media. But he did make a slew of promises at his inauguration in May last year. Top of his list was restoring peace in the Delta and revamping Nigeria's dreadful electricity system. Now he is even further away from doing so than when he took office. Attacks by militants in the Delta have reduced oil output so sharply that Angola is threatening to knock Nigeria off its spot as the continent's biggest producer. Businessmen and potential investors were particularly upset when the EFCC's head, Nuhu Ribadu, who had won international praise for tackling government corruption, was sacked and then banished to a remote corner of Nigeria for "retraining".

But Mr Yar'Adua's admirers say his deliberative style is right for a country with a feeble infrastructure and an array of problems that cannot be solved simply by having oil cash thrown at them. Few think he is personally corrupt—a rare compliment for a Nigerian leader. Some think he should take credit for a relative absence of religious and ethnic strife since he took over a country of 140m people speaking some 250 languages. In the first years of Mr Obasanjo's presidency, tens of thousands of people were killed in civil strife.

But Mr Yar'Adua's ill health is a growing worry. He recently spent more than two weeks in Saudi Arabia, officially on a pilgrimage, but also reportedly for kidney treatment. When a Nigerian news station

reported that he might step down on health grounds, the government yanked the broadcaster temporarily off the air, only magnifying the topic’s sensitivity.

Nicolas Sarkozy

The president who loved summits

Oct 23rd 2008 | PARIS
From The Economist print edition

How the French president has overturned the normal rules of diplomacy





TO UNDERSTAND just how much Nicolas Sarkozy has upturned French diplomacy, try inserting the name Jacques Chirac into the following report. The French president invited himself to Camp David (see picture), where he appeared alongside “dear George”, spoke warmly of “the great American nation” and called for a special summit of G8 countries to “refound capitalism” soon after the American presidential election. The Americans should host it, he declared, “because the crisis took off in New York”. President George Bush, appearing rather startled, limply agreed (the White House has since announced that the summit will meet near Washington, DC, on November 15th).

The whirlwind of emergency summits held or planned by Mr Sarkozy over the past few weeks has been positively dizzying. He wants to hold yet another European Union meeting (France occupies the rotating six-monthly EU presidency) to prepare for the new financial summit. At the end of this week he was due in Beijing for an EU-Asia summit, hoping to get the Chinese and others on board. All this has come after weeks of frantic shuttling, before the financial crisis hit, between Paris, Moscow and Tbilisi in efforts to mediate in the war between Russia and Georgia.

It is hard to recall that, only a few years ago, France’s voice went unheard not only in Washington but also in Europe. Europe was deeply split over the Iraq war in 2003-04. In the EU, France was undermined by its rejection of the constitutional treaty in 2005. Yet today Mr Sarkozy has put France—and Europe—back on the diplomatic map. To be sure, it is easier to behave like an alpha-male leader with a lame-duck American president. And gallingly, Mr Sarkozy has had to share the limelight over Europe’s bank-rescue plan with Britain’s Gordon Brown. But it is the French president who has had the EU mandate to act as globe-trotting European diplomat-in-chief. He has milked it for all it is worth.

Indeed, as Europe congratulates itself on its show of united leadership, the argument is increasingly being heard that it should entrench such a role. Recent events, goes the argument, show that Europe needs a permanent president, as proposed in the Lisbon treaty, which has been on hold since the Irish rejected it in a referendum in June. This week Mr Sarkozy argued that “the world needs a Europe that speaks with a strong voice”, and noted that this was difficult with a rotating presidency. José Manuel Barroso, the European Commission president (above, in the back of the golf-cart), made the same point in an interview with *Le Figaro*. Just think, some mutter darkly, what would have happened if the financial crisis and the

war in Georgia had taken place under the preceding Slovenian presidency.

Yet there is an obvious flaw in this argument: it equates leadership with institutions. If Mr Sarkozy has appeared as a strong European leader, this is because of his political qualities and egotism, not because of the EU's institutional arrangements. Indeed, it is possible to take precisely the opposite line over the Lisbon treaty: that Mr Sarkozy's hyperactivism demonstrates that strong European leadership does not need a new institutional set-up; and even that to have had another worthy as permanent EU president would just have created another obstacle.

For the essence of Mr Sarkozy's approach, at home and abroad, is not to allow the niceties of protocol to get in his way. He seems to have quietly forgotten that the G8 is currently chaired by Japan (the financial summit is now formally a G20 meeting). Nor was it EU orthodoxy to invite Mr Brown to a summit of euro-area members, since Britain is not one. But Mr Sarkozy's unFrench, sleeves-rolled-up pragmatism means doing whatever it takes to get things moving. When his October 4th G4 summit in Paris on the financial crisis failed to prevent each-for-himself squabbling, he simply changed the format and tried again a week later. There are reports that he might want a job for himself as president of future euro-area summits.

It is not clear what would have happened had the Lisbon treaty been in force. Short of a heavyweight figure like Britain's Tony Blair in the job, how would a middling EU president have dealt with Russia or the market meltdown? And how long would Mr Sarkozy have tolerated dithering before stepping in to take things in hand? "No doubt about it," says one French diplomat, "he would have been in the plane with the EU president anyway."

It takes unusual leadership qualities to get European countries to agree to anything, let alone to act beyond their national interests. Arguably, on the financial crisis, and after his first flop, Mr Sarkozy achieved the first, but not the second. His original idea for a common European bank bail-out fund was dropped in the face of German resistance to being seen to pay for others. The current rescue plans may have been co-ordinated, but the details are being decided by individual national governments, and no money is being pooled.

The remaining two months of the French EU presidency will test how lasting are Mr Sarkozy's consensus-building powers. He may have proven his ability to charm, cajole and bully fellow Europeans into a show of unity. But he often leaves in his wake a few bruised egos and much disgruntlement. The Spanish, for instance, were offended to have been left out of his G4 meeting, to which he invited only Britain, Germany and Italy. The Germans were deeply angered earlier this year by Mr Sarkozy's original plan for a Mediterranean Union that would have excluded them, as they have no shoreline on the sea.

With Europe facing recession, diverging interests may create fresh strains. It will be hard to secure an EU summit deal on climate-change targets in December, for instance (see article). Mr Sarkozy's call for European sovereign wealth funds to protect companies from foreign predators was instantly attacked in Germany. His proposed "economic government" for the euro area, long pushed by France, was dismissed by Mr Barroso, who called the notion that such a body might give instructions to the European Central Bank "dangerous". The EU's divisions between free-market liberals and state interventionists will be exposed in rows over subsidies to industry, competition rules and capping executive pay. Mr Sarkozy has shown that he is not Mr Chirac when it comes to leading Europe during a crisis. But many old fault-lines in Europe remain.

France's finance minister

On Lagarde

Oct 23rd 2008 | PARIS
From The Economist print edition

France tests a different type of national champion

EPA


Christine holds her breath

WHEN introducing her at a recent event in Washington, DC, the host reminded her audience that Christine Lagarde, France's finance minister, had once been a member of the French national synchronised-swimming team. Synchronisation, he suggested, was a useful experience in handling the current financial crisis. To which Ms Lagarde added, without missing a beat: "You also have to hold your breath."

France's first female finance minister has been holding her breath a lot recently. A lawyer, with little more than a year in the job before the markets collapsed, Ms Lagarde has been tested more than most by the financial crisis. So far, her calm authority, not to mention elegant English, has won her growing respect abroad. She is a popular guest in New York and Washington. *Forbes* has listed her as one of the 15 most powerful women in the world.

Yet, just as her reputation outside France grows, so it is coming under more attack at home. Parliamentarians feed periodic rumours of her imminent dismissal. The French media leap on her slightest slip of the tongue. Even President Sarkozy insisted, against all protocol, on accompanying her to one of her first euro-group finance ministers' meetings. "The criticism you hear in Paris is very unfair," comments one senior financial figure. Why this disconnect?

One reason is that Ms Lagarde is not a politician. Formerly global head of Baker & McKenzie, in Chicago, where she specialised in labour law and antitrust, she has the disarming tendency of saying what she thinks. When she first stepped off the plane from America, brought into Dominique de Villepin's government in 2005, she caused uproar by declaring that France's labour law was "complicated, heavy" and "a brake on hiring". Mastering French political code has proved tricky. As financial markets continued to tumble, she suggested a bit too hastily that the big risk "is behind us".

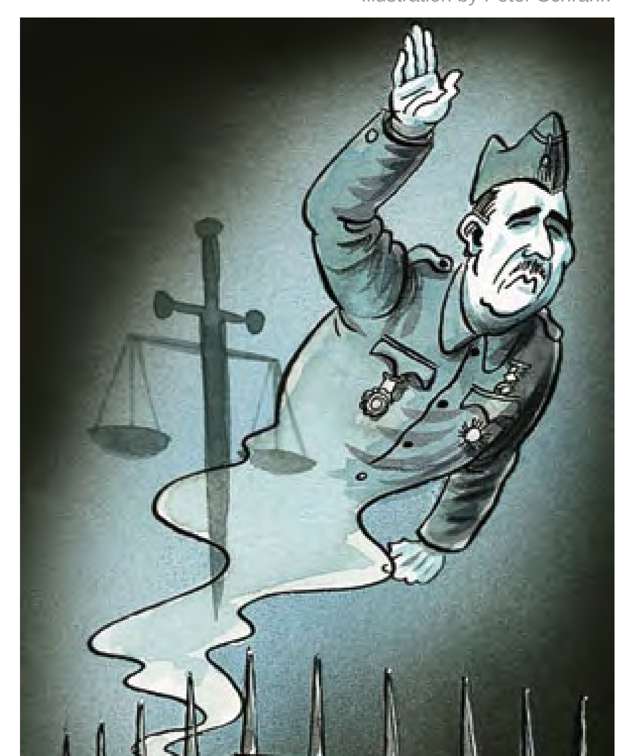
A more basic reason may be suspicion, tinged with jealousy. With over 20 years spent at an American law firm, a perfect command of English, and economically liberal instincts, Ms Lagarde is an embodiment of all that the French elite distrusts—and she is a woman to boot. Deputies in the National Assembly, to say nothing of certain officials in the Elysée, are out to destabilise her. But the voters seem to appreciate her hard work and quiet professionalism. According to the latest *Paris-Match* rankings, Ms Lagarde's popularity jumped in October by five points, to 46%—two points ahead of her boss in the Elysée.

Ghost story

Oct 23rd 2008 | MADRID
From The Economist print edition

Judge Baltasar Garzón indicts a dead dictator and his henchmen

Illustration by Peter Schrank



FRANCISCO FRANCO, the dictator of Spain for 36 years, has been dead for a while. His body was safely deposited in a grave marked by a pharaonic, 150-metre cross in 1975. He belongs to the past. So why has a Spanish judge decided that it is time to accuse the deceased general of committing crimes against humanity?

Judge Baltasar Garzón, the magistrate who is pursuing the general's ghost, has a well-established reputation for testing the limits of the law. In 1998 he had one of Franco's more notorious admirers, Chile's General Augusto Pinochet, arrested in London while he tried to extradite him to Spain for similar crimes.

Now the controversial judge has declared himself competent to investigate 114,000 killings carried out by Franco's people during and after the Spanish civil war. Along with Franco himself, he has accused 34 former generals and ministers of crimes against humanity committed between 1936 and 1951. All are dead.

That means that it is Spain's history that is really on trial. This is no easy matter. The civil war and dictatorship that followed left painful memories. Spain has done its best to sweep these under the carpet. A tacit pact after Franco's death saw politicians of all colours agree not to rake over the past. A 1977 amnesty law settled the terms in writing. None of Franco's henchmen could be tried.

The spirit of that pact, however, had already died before Mr Garzón got involved. Groups of volunteers have been digging up mass graves left by Francoist death squads, returning thousands of victims' remains to their families for reburial. Thousands more are still to be found.

Politicians on the left have meanwhile discovered that bringing up Francoism is a simple way to bait the right. Last year the Socialist government of José Luis Rodríguez Zapatero passed an historical memory law aimed at helping Franco's victims. The opposition People's Party reacted angrily. The PP's position is, however, ambiguous and open to challenge. After all, its founding president, Manuel Fraga, served as a minister under Franco.

Mr Fraga was among the first to criticise Judge Garzón, who has also ordered the digging up of 19 graves, including one in which the poet Federico García Lorca is thought to be buried. It was outlandish, complained Mr Fraga, given the 1977 amnesty law.

The judge has produced a fresh interpretation of those laws. Where a victim's body has never been found, he asserts, a crime of kidnapping continues to this day. So it is not covered by the amnesty. To those who argue that international laws on crimes against humanity did not exist when the civil war ended in 1939, he points to the precedent of the Nuremberg trials of top Nazis. Yet Spain's attorney-general is not impressed. He has accused Mr Garzón of launching an inquisition and lodged an appeal against his case.

Mr Garzón has previously used international human-rights laws to try, condemn and jail in Spain human-rights abusers who worked for military regimes elsewhere, notably in Argentina. Franco and the men he has named so far are dead, but campaigners believe that others who took part in the repression are still alive. Mr Garzón may have opened the way for them, too, to be tried.

East Germany's past

The history boys

Oct 23rd 2008 | BERLIN
From The Economist print edition

East German history continues to arouse controversy

EVERY German schoolchild learns to revile Hitler, but what about Erich Honecker, boss of communist East Germany? He was not a dictator, or so most teenagers from eastern Germany seem to think. And the dreaded Stasi, which jailed and tortured citizens who stepped out of line? Just an intelligence service, say young easterners. These findings, from a survey of 5,200 schoolchildren by Berlin's Free University, dismayed those who think national identity and democratic values rest on shared judgments about the traumatic past.

The ignorance is unevenly spread. Young western Germans know more of East Germany's history. In Bavaria just 39% of schoolchildren had "little or very little" knowledge; in Brandenburg 72% were ill-informed. A third of eastern German students thought that Konrad Adenauer and Willy Brandt, two western giants, actually governed the east. The same proportion judge West Germany's political system to have been the better; two-thirds of westerners do. Such differences persist even among children of western and eastern parents who attend the same Berlin schools.

Teachers who try to correct rosy views of East Germany's past face harassment reminiscent of communist days. Birgit Siegmann, who taught history and civics in Thuringia, says that teachers "had a very special function in East Germany." Besides transmitting ideology to the next generation, they reported on students' political views and visited parents to sniff out non-conformity. With the regime's collapse Ms Siegmann realised what an "unjust state" she had been serving. She tried to pass that insight along by inviting witnesses and victims to the school. But colleagues, nostalgic for the old regime, accused her of "dirtying the nest" and forced her out—she is now at the Stasi museum in Berlin.

The ruling Christian Democrats, who hope to gain votes in next year's election partly by demonising the ex-communist Left Party, is demanding that East German history become a "core subject" in schools. That might not help: most schoolbooks skip lightly over East German repression, and the subject often comes up only at the tail end of the school year. "All lesson plans have East German history," says Henning Schluss, who works on education for the Protestant church. "That doesn't mean they will be implemented."

Resistance to a reckoning is not fading. "When East Germany's history is reduced to the Stasi, political prisons and the Wall, we take the past away from its citizens and their children," Cornelia Falken, a teacher and Left Party legislator, said in a recent debate in Saxony. The argument may restart with the release of "Anonyma: A Woman in Berlin", a film about rapes committed at the end of the war by the Red Army, heroes to East Germans. Germany may be reunited, but its views of history are anything but.

Italian immigration

When Brussels trumps Rome

Oct 23rd 2008 | ROME
From The Economist print edition

The Berlusconi government is forced to soften its anti-immigration measures

AT ITS first meeting last May, Silvio Berlusconi's government approved a tough "security package" to stem illegal immigration and sling out unwanted foreigners. This week, the Senate will debate the latest measure to implement it—or rather not. For in the five months since Mr Berlusconi promised to guarantee "the right of Italians not to be afraid", his security package has been chiselled away by Eurocrats in Brussels and battered by a brusque contact with reality. Indeed, it has become a paradigm of the difficulties that European governments face if they try to introduce the sorts of measures voters like.

Of four main provisions in the package, only the deployment of troops in support of the police has been fully introduced. Some 3,000 soldiers are to remain on civilian security duty until at least January.

The most recent pledge to be ditched was one to imprison clandestine immigrants for up to four years. Mr Berlusconi's interior minister, Roberto Maroni, told a parliamentary committee on October 15th that they would now be fined, not jailed. Officials explained that there was not enough room in the prisons. Mr Maroni insisted that the main aim, to make clandestine immigration illegal, allowing judges to expel people quickly, remained. But the problem is that such immigrants often arrive with no documents, and claim to be from somewhere other than their homeland. When diplomats of the country of which they claim to be citizens disown them, the authorities have nowhere to send them back to. Arrangements for instant expulsion also raise concerns about asylum seekers' rights. Laura Boldrini of the office of the UN High Commissioner for Refugees says that "it is essential asylum seekers be exempted from any punishment imposed on those who enter without papers, because a lot of asylum seekers have no papers when they arrive."

Bad news being best bundled, Mr Maroni used his committee appearance to announce a second climb-down: the ending of a provision for automatic expulsion for EU citizens who cannot show that they have adequate means of subsistence. This was devised to get rid of Romanian Roma (gypsies). But as critics complained from the outset, it clashed with EU laws on free movement of people. The EU justice commissioner, Jacques Barrot, gave warning only last month that "within a very short time frame", he would start infringement proceedings against Italy.

Mr Maroni insisted that he would continue with the destruction of unauthorised gypsy encampments and that the expulsion of Roma would still be possible. Every foreigner in Italy for more than 90 days must have a residence permit. If a gypsy could not prove he had a certain minimum income, he would not get one. That would make him an illegal immigrant, liable to the same rapid expulsion as an *extracomunitario* (ie, non-EU citizen). If he had a criminal record, he could also be removed. But, as Mr Barrot signalled, the commission remains unhappy with the legislation Italy is preparing. Officials in Brussels say EU rules allow neither the setting of a minimum income nor the expulsion of undesirables from one member to another, save in very restricted cases.

A fourth bit of the security package required the courts to add a third to the sentences or fines imposed on non-Italians living in Italy illegally. That will still apply to *extracomunitari*. But on September 19th the head of a delegation from the European Parliament said that he had secured from Mr Maroni an undertaking it would not be invoked for EU citizens.

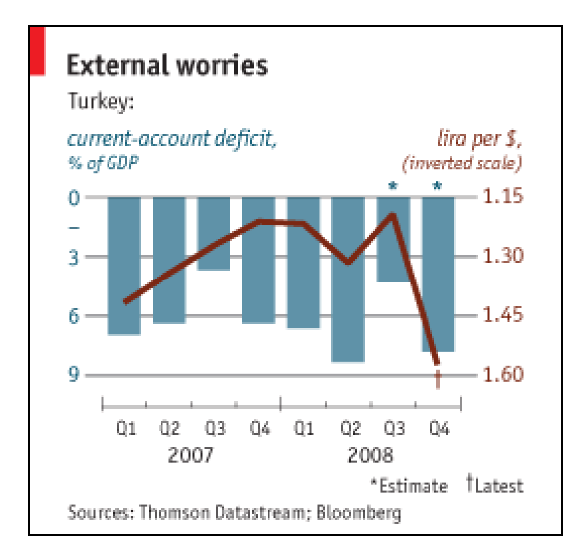
What many in Mr Berlusconi's ruling majority appear not to realise is that the free-movement directive, which came into force two years ago, gives EU citizens (beggars and crooks included) essentially the same rights as locals. The politics of "them" and "us" in the EU no longer applies. Except, of course, at election time.

Turkey's economy

In need of an anchor

Oct 23rd 2008 | ANKARA
From The Economist print edition

The Turkish economy may be more vulnerable than it looks



WHEN the world economy was in trouble at the start of the decade, Turkey was hit especially hard. A spectacular currency and banking crisis triggered one of the IMF's biggest-ever bail-outs. This time, emerging markets around central and eastern Europe are provoking worries (see article)—but so far Turkey is not. Indeed, far from seeking outside financial assistance, the government ended its formal IMF programme in May, when Mehmet Simsek, the economy minister, proudly proclaimed the emancipation of Turkey from IMF guidance. He may come to regret his moment of hubris.

Certainly, six years of strong growth have made the economy, the sixth-biggest in Europe, far healthier. The banks seem sound: Mr Simsek points to a high average capital-adequacy ratio of 17.5% and relatively few non-performing loans. Population growth keeps up demand. Exports are more diversified (Turkey's five biggest markets now take 37% of exports, down from 50% five years ago). The public debt has fallen from 74% of GDP in 2001 to just 39%. Foreign-exchange reserves have climbed to almost $80 billion. The economy seems unlikely to tip into recession.

Yet it would be wrong to be too sanguine. As elsewhere, GDP growth has slowed sharply. Half the country's exports go to the European Union, which is facing recession. Inflation, an old bugbear, has crept back into double figures. And the current-account deficit has widened to 6.4% of GDP. Turkey depends on foreign investment, running at some $20 billion a year, to fill the gap. No wonder the stockmarket and the lira have taken a pasting.

Turkey also has big structural economic problems. The government has pushed through modest labour-market reforms and a new social-security law, but productivity growth is low and there is a dearth of competition in the economy. Sectors that have done well in recent years, like cars, textiles and white goods, are exposed both to a European recession and to rising competition from China.

The biggest problem is not finding the right policies but, in a fractious political arena, securing consent for them. As a technocrat, Mr Simsek has a good medium-term fiscal strategy, but there are doubts about his political support. Experience suggests that Turkey works best with a strong external anchor. In economics, that has since 2001 been the IMF; in broader politics, it has been the prospect of joining the EU. Sadly, neither is solid just now.

Mr Simsek points to the value of post-programme monitoring by the IMF, but that is not as powerful as a full standby facility. Yet having passed up the chance of one in May, the government would find it hard now to request a new programme without spooking the markets. Similarly, although the foreign minister, Ali Babacan, has just published an ambitious national plan for Turkey's EU accession, the talks are making little progress and next month's report from the European Commission will criticise the slowing pace of Turkish reform. Turkish public opinion sometimes favours a go-it-alone strategy for the country; but in the absence of firm anchors, that is unlikely to promote either economic or political stability.

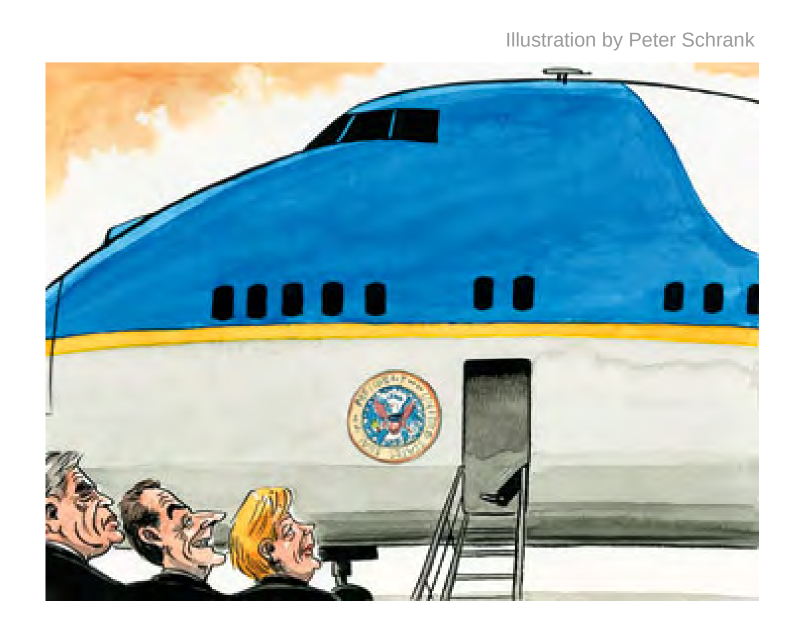
Charlemagne

Preparing for a new president

Oct 23rd 2008
From The Economist print edition

What the Europeans hope for after the American election

Illustration by Peter Schrank



HERE is a happy vision from the near future. It is a winter's day in Prague, early in 2009, and America's new president is starting his first visit to Europe. The cold cannot deter a waiting crowd of hundreds of thousands, watched by a press pack only slightly smaller. The choice of Prague honours Europe's triumph over Soviet repression, television reporters intone, as Air Force One banks majestically in the winter sunshine. (Few mention a more prosaic explanation: that the Czechs hold the rotating presidency of the European Union in the first half of 2009.)

Later, in a speech in Wenceslas Square, the new president pledges to embrace the "transatlantic values" of America's founding fathers. He announces a date for the closure of the Guantánamo Bay prison camp (to cheers) and an absolute ban on torture. He proposes talks on joint action by America and the European Union to fight climate change. The crowd is more muted: in central Europe, it turns out, people are more worried about a recession than about greenhouse gases.

From Prague, the president flies on to Berlin and London. (The French president, Nicolas Sarkozy, is ahead of other EU leaders. A speedy sort, Mr Sarkozy used his status as sponsor of a summit on the financial crisis to meet the president-elect in November 2008.) In closed-door meetings, the new president asks European leaders what they seek from America. In return, he sets out the help he needs from Europe. And that is where the trouble starts.

Return to the present day. Is there hope of better transatlantic ties after the American election? The picture is mixed. It helps that both Germany and France are run by pro-American leaders who are unlike their predecessors. There is no reason why the financial crisis should divide Europe and America. True, the past few weeks have seen fiery rhetoric from Mr Sarkozy about "reinventing capitalism". But Europe runs on free markets, too. France does not have majority support for an assault on tough EU rules against state aid. European leaders say they are ready for serious talks on a new world financial architecture to replace the Bretton Woods system. They may or may not mean it—the adjustments will be painful (eg, who can justify the fact that Benelux countries enjoy a greater voting weight at the IMF than China?).

Europe and America may not fully agree on climate change, but they can make common cause against polluters like China, which has started arguing that carbon emitted by Chinese factories is not their problem, because it is "embedded" in goods for export. Yet other issues will be tougher. Perhaps the hardest is Afghanistan. President Barack Obama (or President John McCain, come to that) will ask

European governments for thousands of extra troops, to be deployed without the "caveats" that currently keep most European forces away from fighting in the south and east. Countries with troops in those areas, including Britain, the Netherlands, Poland and Denmark, feel overstretched already. Germany cannot give Mr Obama what he wants: public opinion will not allow it and an election looms in the autumn of 2009. In France opinion is equally strained: after the deaths of ten French soldiers this summer in a Taliban ambush opinion polls called for all French forces to come home.

John Hulsman, an American analyst at the German Council on Foreign Relations, predicts trouble over Iran at a first meeting between the German chancellor, Angela Merkel, and the next American president. Europe will not tolerate bombing Iranian nuclear sites, Ms Merkel may say. Fine, the president may reply. But then America needs an investment freeze in Iran, starting with big companies from Germany (the Germans reject tough sanctions). Ms Merkel may also raise the Doha world trade talks, scuppered by a row this summer over American farm subsidies. Again, the next American president may have a difficult request in return, says Mr Hulsman: a demand that Europe undertakes a slashing reform of the common agricultural policy.

Some Europeans suppose that Mr Obama is softer on Russia than Mr McCain. Well-informed folk say that Mr Obama sees today's Russia as an "outlier" in the international system. But America alone cannot dictate Russia policy to NATO, he believes. Under a President Obama, it is said, a first move towards Russia would be to set America's relationship with Europe in order. The risk is that Europeans may come to the new president with a list of rebukes, plus demands not to isolate Russia.

Adversity maketh better transatlantic manners

Yet in the longer run the chances of better transatlantic co-operation may be greater than they seem at first sight. The reason is simple. For both Europe and America the long-term outlook is quite bleak. Global acceptance of American leadership has diminished both because of the Iraq war (and Guantánamo) and because of the rise of emerging powers with different ideas about how to order the world, some of which carry a whiff of 19th century great-power rivalries. Today's Europe has little military clout, and is in demographic and (relative) economic decline.

A relative decline in Western power makes it more urgent for Europeans and Americans to repair the Western alliance. Wolfgang Ischinger, who has served as German ambassador in both Washington and London, thinks this could be based on a return to former values. If the West's approach to the world can be summed up in one idea, it is the enlightenment doctrine that the power of monarchs and absolute rulers must be restrained by laws, he told a retreat organised by the BELA Foundation, a German-Polish policy outfit. The West should redesign the architecture and governance of the world "while we still have influence".

In short, America and Europe need each other and they can still do much together. And if they do not understand that now, in 20 years' time others will be shaping the world, in ways that may not follow Western enlightenment values at all. That is not a happy vision for anyone.

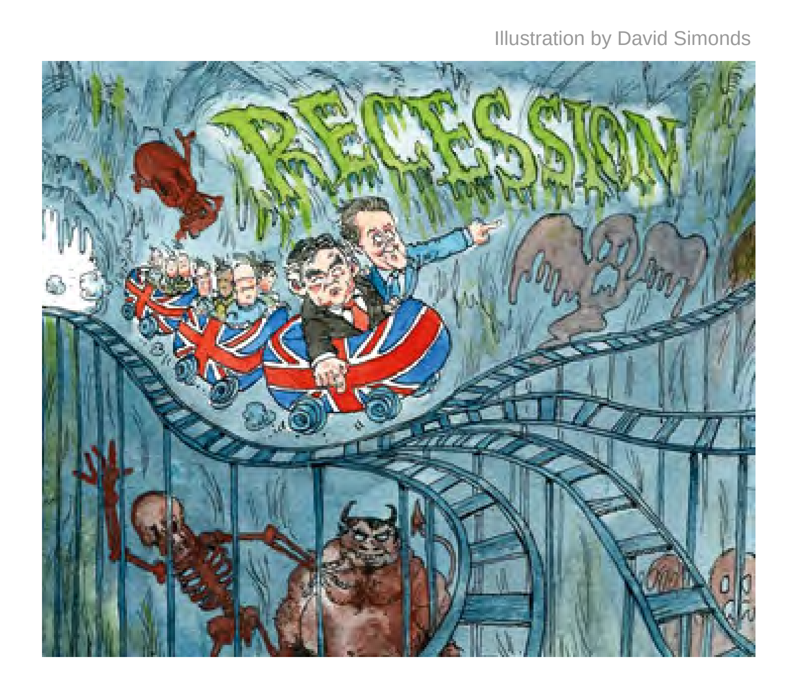
The politics of a shrinking economy

End of the phoney peace

Oct 23rd 2008
From The Economist print edition

Britain is entering a recession. Labour and the Conservatives disagree on how to soften it

Illustration by David Simonds



THE last time the British economy was contracting, George Osborne was a student. This week, only a scandal involving the Conservative Treasury spokesman (see article) drew attention from the most dismal economic news since 1992. Figures to be published on October 24th were expected to confirm that the three months to the end of September saw the first quarter of negative growth for more than 16 years. Gordon Brown admitted on October 22nd that Britain was almost certainly heading into recession, and a day before the prime minister spoke, Mervyn King offered his grimmest take on the economy in his five-year stint as governor of the Bank of England, warning of "a sharp and prolonged slowdown in domestic demand." The pound promptly fell to its lowest level against the dollar since 2003.

Mr King's emphasis on recession, together with notes from the previous meeting of the Monetary Policy Committee showing that its members voted unanimously for the half-point cut in the base rate announced on October 8th, suggests enough worry to prompt another rate cut, perhaps as early as November. Companies would welcome it: the latest survey by the Confederation of British Industry, the main employers' body, recorded the steepest single-quarter fall in manufacturing confidence since 1980.

Most of this gloom has been widely predicted: it was only a matter of time before the financial crisis began to afflict the real economy, and growth had already stalled in the previous quarter. But Mr Osborne is not the only Briton who has never known a recession in his working life. The psychological impact of a shrinking economy may be huge precisely because it is unfamiliar. And whereas the credit crunch has hit much of the world, it may cause especial upheaval in heavily indebted Britain—not least politically. The past month has seen an emboldened prime minister, a diminished opposition, an improbable cabinet reshuffle, and the rise and fall of a political truce between the government and the opposition. All this before a recession had officially begun.

We're not all Keynesians now

Yet Westminster-watchers thrown by this turbulence are now being treated to a comfortingly familiar spectacle. Public spending versus tax cuts—the argument that split Labour and the Tories at the previous two general elections—again divides the country's main parties. In both 2001 and 2005 they were arguing

about what to do with the tax revenues then cascading into government coffers. The dispute now is over the best way to mitigate a recession.

On October 19th Alistair Darling, the chancellor of the exchequer, suggested he would try to boost demand by scrapping previous plans to restrain the rate of increase in public spending and bringing forward to 2009-10 money earmarked for the following year. Details will come in his pre-budget report in November, but some expenditure has already been fast-tracked in housing and defence. Other candidates for early dollops of cash are schools, medical facilities and leisure centres. Figures released on October 20th showed that government borrowing had already hit a post-war high in the first half of this fiscal year. But after chiselling away at public debt during the boom years, insists Mr Darling, the government can now safely borrow a bit more to prime the pump.

The Tories, whose "statesmanlike" support for the government during the banking crisis ended abruptly with a speech by David Cameron, their leader, on October 17th, have other ideas. Keynesian boondoggles are acceptable in principle, they say, but they cite Japan in the 1990s as proof that such spending does not always stimulate the economy: better to boost businesses' cashflow by easing their tax burden. Under Tory plans, firms employing up to 250 workers could defer payment of value-added tax (VAT) for six months, while those with up to four employees and a wage bill of less than £150,000 ($255,000) would get a cut of one percentage point in their national-insurance contributions.

This break with the government is a calculated gamble by the Tories. After all, voters plumped for spending over tax cuts in both 2001 and 2005. But the Conservatives are not offering an overall cut this time. Instead, the VAT holiday would be paid for by interest charged on the deferred tax, and the national-insurance cut would be funded by ditching various reliefs and allowances. Moreover, a resumption of hostilities with the government is in the Tories' political interests: their non-aggression pact with Mr Brown allowed him to become the hero of the financial crisis while dodging any blame for it.

And though Mr Darling's plans evoke Keynesian high theory, they may crash on rocks of the most mundane kind. Thanks to planning restrictions and other pesky hold-ups, spending public money quickly in Britain is not always easy. The government's schools-building programme is already behind schedule. Raising the private finance that helps pay for many public-sector capital projects is also likely to take longer than usual. The last global slowdown, in 2001-02, coincided with a spending splurge that Mr Brown, then chancellor, had already set in motion. This time the pump-priming may come too late to relieve a far more serious downturn.

The Tories are not invulnerable, of course, despite their continuing lead in the polls. Small, targeted tax reliefs may strike voters as a piffling response. There are doubts about whether their VAT policy complies with European Union law, though the party is confident it does. And if the Tories do win the next election (which must be held by June 2010) despite the government's spending wheeze, they may find the public finances in even direr shape than now looks likely.

For all that gladiatorial politics is here again, the differences between the parties should not be overstated. Neither is so far trumpeting the need for an overall massive spending rise or tax cut. But Britain is entering a recession with its main protagonists divided in important ways about how to get out of it. The stakes are higher for the government, if only because its plan will be the one that is tested by reality. If it works, the recent bounce in Mr Brown's popularity may come to be seen as just the start of a journey back to electability. If it fails, the prime minister will return to being the sure-fire loser of the next election. For a really deep recession will surely be too much for voters to forgive, whether or not they can remember the last one.

Equality

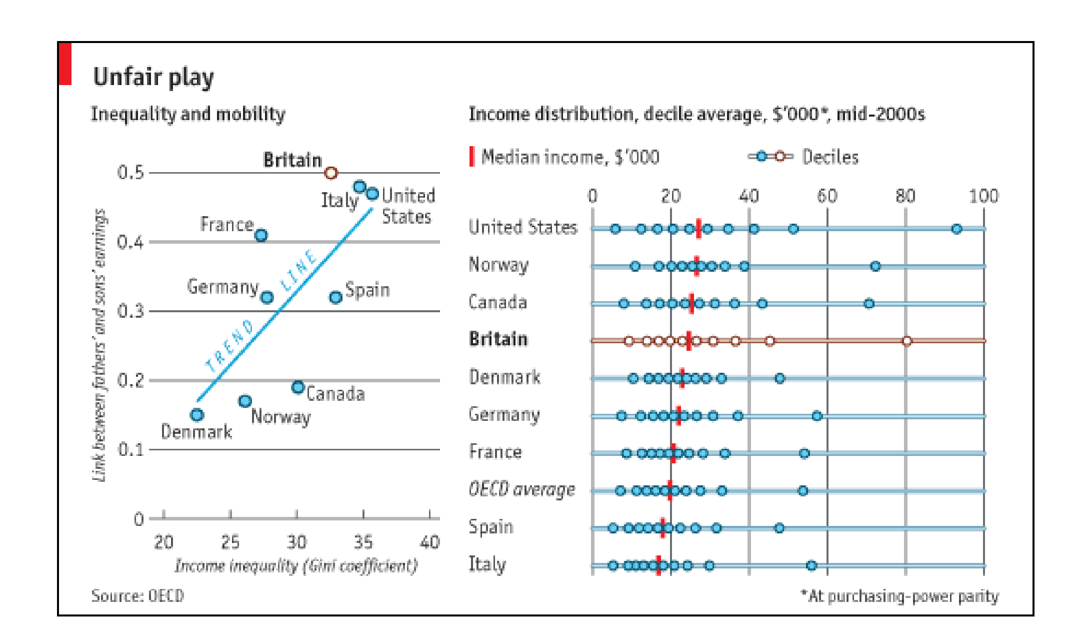
Pain all round, please

Oct 23rd 2008
From The Economist print edition

The importance of fairness in an economic downturn

EQUALITY means very different things to different people. Britons, for their part, are less convinced that folk should be similarly prosperous than that they should have an equal shot at success. The government shifts money around a bit by taxing and redistributing it (less than in the Nordic countries, more than in America), but the big goal is to make sure that anyone who works hard can get ahead.

A report published on October 21st by the Organisation for Economic Development (OECD), a club of 30, mostly rich, countries, shows that, sadly, Britons get neither equal outcomes nor equal chances. Income is distributed more unequally than in most OECD countries, as measured by the widely used Gini coefficient (see chart)—and more unequally than in any rich one except America and Italy. Nor is equality of opportunity much in evidence: a son's income depends more strongly on his father's in Britain than in any other country for which the OECD has data.



Across the developed world the gap between rich and poor has grown for two decades now. That has been particularly true in Britain's open economy. An influx of wealthy financiers and unskilled eastern European labourers has stretched the range of earnings at both ends. Those at the top grabbed a bigger share of the rewards of growth than elsewhere: as the chart shows, Britain's richest 10% outstripped the next 10% by a huge margin. Meanwhile, high rates of family breakdown and lone parenthood have swelled the ranks of the poor.

Even so, says the OECD, between 2000 and 2005 both poverty and income inequality fell in Britain, and faster than anywhere else in the OECD. Stealthy redistribution helped stragglers keep up, and so did strong growth in employment.

Yet the days of lessening inequality ended at about the same time as the OECD's analysis. In the two years following, according to Britain's statistics office, income inequality took off again, as wage differentials waxed and government generosity waned. Now that recession looms, and without the demonstrable social mobility that might justify such disparities, demand for a new sort of equality is growing. And this is equality of sacrifice—that those at the top suffer as much as the rest.



Graduate recruitment

What next?

Oct 23rd 2008
From The Economist print edition

The work that awaits the class of 2009

ALREADY the financial crisis is taking its toll on the employment market: the jobless total rose by 164,000 in the three months to September, the biggest rise for 17 years, and the number claiming jobseeker's allowance jumped again in September. Much of the pain is being felt near the bottom of the jobs ladder, as house-building grinds to a halt. But well-paid work is scarcer too: according to Morgan McKinley, a recruitment specialist, vacancies in the City of London are 40% lower than last year, with a 42% rise in the numbers looking for work in financial services.

The class of 2008 is probably safe: recruiters decided how many of them to take on before the recent turmoil, and most honoured their promises. But what of the class of 2009? "We've had five years of continuous growth in the graduate-jobs market," says Carl Gilleard of the Association of Graduate Recruiters. "I can't see that growth continuing." In July a survey of its members showed graduate recruitment holding steady. But even then confidence was waning: it found the lowest increase in starting pay in recent years, and most employers said there would be at best a cost-of-living rise next year.

The consensus, it seems, is that graduates in 2009 will emerge from their studies into a world that is chillier, rather than utterly changed. Some would-be high-fliers will simply switch from one A-list career to another: there are early signs of a surge of interest in postgraduate training for law; management consultancy will attract some who might previously have gone into banking or finance. Even in fields directly affected by the downturn, hiring has slowed, not stopped. There are still new jobs in finance, says Kevin Green of the Recruitment and Employment Confederation, although they are fewer and are now more likely to be in risk management and IT than in sales.

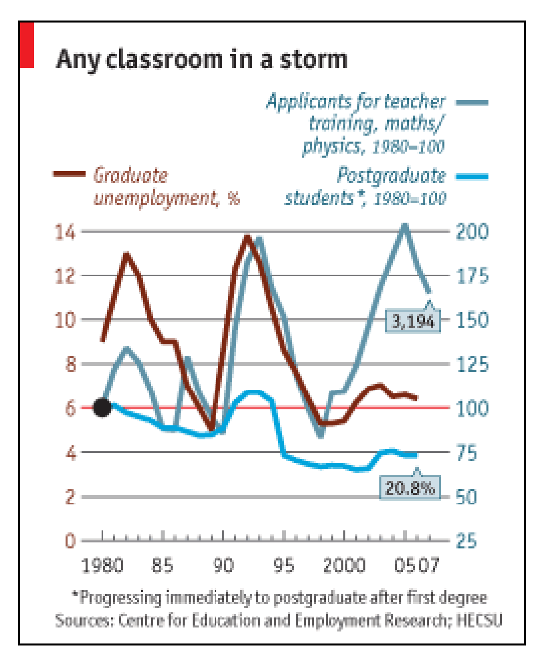
Most graduate employers will keep hiring at least a few bright young things, says John Philpott of the Chartered Institute for Personnel and Development: "During the recession of the 1990s many didn't, and suffered later." Global businesses will still hire too, but may ask their graduate recruits to work abroad at first, he thinks.

The most profound effect of the downturn may be not on employers' thinking, but on graduates'. Unlike their elders, they have no memories of previous recessions, and no experience of gritting their teeth and waiting for better times. One beneficiary is likely to be the public sector, as job security and final-salary pensions look particularly appealing right now. "I used to recruit for the public sector," says Mr Gilleard, "and whenever there was a mini-recession we got the sort of high-fliers applying that we wouldn't normally see."

Other graduates will decide to put off the day of reckoning: post-university gap years may become more popular, says Mr Green (although he warns that 2010 could prove just as tough a time to look for work, so gappers had better do something suitably CV-enhancing). And research by the Higher Education Careers Services Unit shows that more graduates keep studying when the jobs market is tight (see chart). "In 1992, when unemployment reached its highest level since the early 1980s, more than 30% of students went straight back into higher education after graduating," says its chief executive, Mike Hill. "So we're likely to see a surge in postgraduate entry in the next couple of years."

The biggest winner from recession may be the teaching profession—particularly in maths and physics, where it has long struggled to compete for talent with banking and finance. Applications for teacher training in these subjects go up when the government offers golden hellos and other incentives, say Alan

Smithers and Pamela Robinson of Buckingham University—but high graduate unemployment causes a surge too. It looks as if the pattern is set to repeat: the Training and Development Agency, which oversees teacher training, says its website has received a third more hits this year than last, and registrations of interest are also up. Hidden inside one crisis may be the solution to another.



Literary legacies

An uncommon gift

Oct 23rd 2008
From The Economist print edition

Thanks to the nanny state

BRITISH libraries seeking original literary archives—the ore from which most original scholarship is mined—have to contend with heavy competition from America and precious little in the way of funds with which to pay authors for their notes and scribblings.

Over the years, the archives of Sir Salman Rushdie, Sir V.S. Naipaul and his first wife, Patricia, and Sir Tom Stoppard, among others, have all been sold to wealthy American universities. At the end of last year, the British Library bid £1.1m ($2.2m) for the papers of Harold Pinter, the playwright and Nobel laureate. Earlier this month, it put down another £500,000 for the poet Ted Hughes's estate; his 6,000-volume library had earlier been sold for a considerable sum to Emory University in Atlanta, Georgia. But all these purchases have been possible only thanks to the generosity of private donors.

So just imagine the smiles that have broken out at Oxford University. On October 27th it will announce that the playwright Alan Bennett, chronicler of kings and queens and history boys, is leaving his entire literary estate to the Bodleian Library—free of charge.

The first tranche—100 boxes—includes the manuscript drafts of all Mr Bennett's major works from "Beyond the Fringe", a stage review from 1960, to his most recent volume, "An Uncommon Reader". His notes, letters and diaries, not all of which have been published, will follow. It is the largest literary donation in recent times.

The gift was suggested by Mr Bennett's undergraduate friend, David Vaisey, who rose to become Bodley's Librarian. But the idea of asking nothing for it was Mr Bennett's alone.

"I felt in a way it's a recompense for the education I was given," the writer told *The Economist*. "I went to a state school in Leeds. I went to Oxford on a scholarship. I benefited at every stage from the nanny state, as it is disparagingly called. It would be unimaginable now to be a student and free of money worries. But I was lucky in my time and I'm grateful to be nannied."

Abortion in Northern Ireland

No change

Oct 23rd 2008 | BELFAST
From The Economist print edition

An attempt to extend British law to Northern Ireland bites the dust

THEY agree on little else, but the heads of Northern Ireland's four main parties are united in their determination to deny their countrywomen access to free abortion at home. The government in London, it seems, is happy to go along. Debate on a proposed amendment to extend Britain's liberal laws on the matter to Northern Ireland was denied on October 22nd, as a controversial bill on fertility and stem-cell research passed the House of Commons.

Northern Ireland allows abortion only if a woman's life or long-term health is endangered. At least 1,400 women a year travel to Britain for abortions and, unlike their English, Scottish and Welsh compatriots, must pay for them—at least £450 for the procedure, plus travel costs.

The amendment relegated on Wednesday was tabled by Diane Abbott, a left-wing Labour MP, who said she stepped in when party bosses deterred others. A strong supporter of abortion, she said it was a matter of principle: "If I break my leg in Belfast I can get it fixed on the NHS, but a woman there is not just prevented from having an abortion at home, she's not entitled to a free abortion here." Audrey Simpson, head of the Family Planning Association in Belfast, says more and more callers ask for advice on abortion-inducing drugs bought online as a cheap alternative to travel. Without medical supervision, such drugs can cause complications: "I'm just afraid a woman or young girl will die."

But medical arguments were trumped by political ones. Squashing the amendment repaid a debt allegedly incurred to unionists in May, when votes from the Democratic Unionist Party (DUP) saved the British government from defeat on proposals to allow detention of terrorist suspects for 42 days without charge.

Northern Ireland's politicians could, if they liked, decide the issue for themselves. A stand-off between the DUP and Sinn Fein, the biggest nationalist party, on policing and criminal justice (among other issues) has blocked meetings of the power-sharing executive at Stormont since June. If the logjam is broken, criminal justice—including abortion law—will become Belfast's responsibility. But that will make reform less likely, not more.

Social conservatism crosses Northern Ireland's political and religious barricades, and attitudes change only slowly. Tolerance of homosexuality, for example, is patchy, but has improved since 1977, when the Rev Ian Paisley, founder of the DUP, launched "Save Ulster from Sodomy", a campaign to prevent Britain from applying its recently liberalised laws to Northern Ireland (four years later the European Court of Human Rights forced it to). Tom Hartley, Belfast's Sinn Fein mayor, beamed at a Gay Pride event this year, and many turned out to admire the ultra-glam floats. Last year's event saw placards cheekily urging "Save Sodomy from Ulster".

Yet for many abortion remains beyond the pale. Even in more tolerant Britain, governments generally hesitate to try to extend abortion rights, first codified in 1967 by a (government-backed) private members' bill. Hence the attempt by today's liberalisers to ride the coat-tails of a bill on fertility treatment. Northern Ireland's government is unlikely to be braver than Britain's. Women will be crossing the Irish Sea for many years to come.



Migration

Coming or going?

Oct 23rd 2008
From The Economist print edition

Immigration will probably fall in an iffy economy. But emigration might too

FAILURES in asylum policy have spread "untold human misery"; immigration authorities did not know what they were doing; it has been "too easy" to get into Britain. Phil Woolas, the new immigration minister, has not been shy of stirring things up since he started the job earlier this month. Along with much bluster he appeared to announce two new policies: that the government would not allow the population to rise above 70m (it is now 61m) and, more obliquely, that immigration might be subjected to annual quotas.

There has since been some back-pedalling, and many think that the minister went further than he intended, citing another unguarded remark about the disestablishment of the Church of England (imminent, Mr Woolas said; unthinkable, the Ministry of Justice promptly corrected). But his immigration proposal was probably no gaffe. Mr Woolas made the remarks twice, to the *Sunday Times* and, a week later, to the *Times*. His Labour colleagues are in no doubt. "He was sent over the top with approval," one MP says.

Labour knows it must calm Britons' nerves about migration, which may be set further on edge as unemployment rises. Migration has soared: a million people came and went in 2006, more than double the traffic 20 years earlier (see chart). Inflows have grown faster than outflows: a net exporter of people until the early 1980s, Britain now has net immigration of about 190,000 a year. This is due mainly to enlargement of the European Union (to include eight job-hungry central and east European countries), a big higher-education sector (sucking in foreign students) and more marriage visas (thanks to lighter rules on how they are given out).

Fluid dynamics

British migration flows by citizenship, '000

Britain; European Union; Old Commonwealth*; Remaining Commonwealth; Other foreign†

IMMIGRATION / EMIGRATION

600, 500, 400, 300, 200, 100, 0, 100, 200, 300, 400, 500

1964, 70, 80, 90, 2000, 06

Source: ONS

*Australia, Canada, New Zealand
†Includes all Europeans until 1975

The annual quota that the Tories want and Mr Woolas seemed to be flirting with would miss most of these newcomers. Non-European workers, to whom alone it would apply, make up just a fifth of immigrants when students (who bring in lots of money) are excluded. They are hard to cut back: unskilled non-Europeans are already banned, so this category is mostly full of useful, well-paid types.

A different approach is to prevent immigrants from staying on. The government has already made it harder to gain citizenship by introducing tests on language and culture, though this has been done in the name of improving social cohesion rather than keeping numbers down. A cross-party group of MPs is talking of a four-year time limit for immigrant workers, after which they would have to apply to stay on via a second points system, limited by quota. Critics say that similar "guest-worker" schemes in other countries have removed the incentive for immigrants to integrate and created problems with overstayers. Proponents say these can be solved with stricter enforcement, though that is not a traditional strength of the Home Office.

Recession should make it easier for Mr Woolas to keep his promise to cut numbers. In the second quarter of this year, registrations by east European workers were about a quarter lower than they were at the same time in 2007. But the other half of the balance sheet—emigration—is harder to predict. During the economic gloom of the 1970s, for example, Britons became less likely to emigrate, not more. And as things brightened in the 1990s, more packed their bags. The Institute for Public Policy Research, a think-tank, has found that the correlation between emigration and misery-indices such as unemployment is

weak.

If anything, increasing prosperity and a strong pound have enabled Britons to escape to the sun—meaning that crashing house prices might cause emigration to dip too. Age Concern, a British charity with offices in Spain, reports that more British pensioners are fleeing back to Britain from the strong euro. That would at least make sense of one anomaly: as winter draws in on the Costa del Sol, Britons abroad continue to claim “winter-fuel allowance” of up to £400 a year from the British taxpayer.

Economist.com WORLD BRITAIN

Pension problems

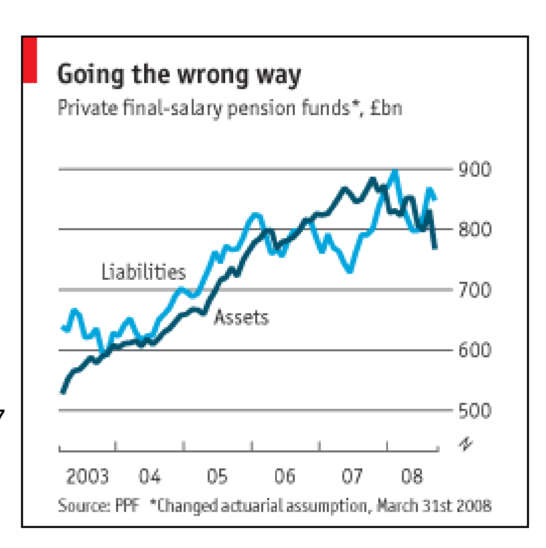
Model at risk

Oct 23rd 2008
From The Economist print edition

Final-salary schemes are looking ever less credible

DAILY doses of appalling financial news have focused attention on quick fixes and emergency saves. But longer-term worries loom for workers who see their pensions shrivelling. On October 20th the government proposed clarifying the powers of the pensions regulator, an official watchdog, to make firms top up underfunded schemes and to combat conflicts of interest when companies transfer pension liabilities by buying annuities. Broader reform is also in the works.

The impact of crashing stockmarkets on workers with defined-contribution schemes, whose payout depends on the investment performance of the underlying funds, is obvious; but the 12m members of Britain's 7,800 final-salary schemes could be vulnerable as well. The employers that "sponsor" these defined-benefit (DB) plans face years of little growth or worse. Many are struggling to keep their schemes in funds. And a growing number want to get rid of their open-ended liabilities.



Though fear of widespread pension-fund failures is a recurring theme in Britain, the numbers this time are disquieting. According to the Pension Protection Fund (PPF), which insures them, DB schemes have swung from a £75 billion surplus in September 2007 to an £80 billion deficit (see chart). The shortfall more than doubled in September 2008, and 6,345 plans were in deficit at the end of that month.

The situation could be bleaker still, says Deborah Cooper at Mercer, a financial consultant. Accounting rules let firms discount future pension liabilities by a rate equal to the yield on grade-AA corporate bonds. Fear that firms will default on their bonds has pushed up yields, thus reducing the size of their pension liabilities. Deficits are larger, she says, if you use adjusted government-bond yields as the discount rate.

These deficits are bad for the PPF, the companies that pay it an annual risk-based levy and the taxpayers who would have to come up with the difference should the PPF run out. Nor is it heartening for scheme members who have not yet retired, for the PPF pays them only 90% of promised pensions, and up to a limit of £27,770 a year.

Final-salary schemes were set up when firms felt paternal towards their workers and there was faith in long-term equity returns. But times and markets have changed. Ros Altmann, an independent pensions expert, thinks the DB model "little better than a Ponzi scheme", since a badly-performing fund can delay fully funding its liabilities. Valuation is fraught with controversy—over discount rates, reinvestment risk and longevity, for starters.

Some firms have tried to reduce their risk by swapping pension assets for a stream of annuity payments from an insurance company or other provider. The biggest deal to date is that of Cable & Wireless, a communications company, which exchanged half of its DB liabilities—roughly £1 billion—for annuity payments from Prudential, an insurance company, in September. In all, perhaps £40 billion of liabilities have been shifted over the past two years, a modest proportion of total estimated DB pension liabilities of £1 trillion.

The pensions regulator and the PPF want to be sure that such transfers of liability do not disadvantage members of pension schemes, or saddle the PPF with more claims. So do firms that pay into the PPF. There is therefore support in most quarters for the government's proposal to give the regulator more power to deter a new breed of investors from buying pension assets for profit to the detriment of beneficiaries.

This is only part, however, of a bigger push by government to get all employees into some sort of pension scheme, and to make companies responsible, from 2010, for seeing that they are. One route could be to set up “personal accounts” carried from job to job, which would decouple a worker’s pension from the fortunes of any one employer. Another might be to encourage new DB schemes by letting firms copy the “conditional indexation” used in the Netherlands, which allows a firm to adjust pension rights according to how well its pension fund is doing. One way or another, British pensions are set to change.

Bagehot

The king of Corfu

Oct 23rd 2008
From The Economist print edition

George Osborne should have thought more carefully before crossing the business secretary

Illustration by Steve O'Brien



PERHAPS it was a genuine misunderstanding. The waves lap, the moon glistens on the wine-dark sea, the *retsina* flows, the stars and gold taps sparkle. In the morning, no one can agree whose idea it first was to play charades, go skinny-dipping or solicit an illegal donation from a Russian oligarch.

August in Corfu: Peter Mandelson, then the European Union's trade commissioner, allegedly "dripped pure poison" about Gordon Brown into the ears of George Osborne, the shadow chancellor. Then Mr Mandelson was stunningly recalled to government as business secretary—and Mr Osborne leaked some details of their holiday chat. He was foolish to do so. The old bitterness between the newly ennobled Lord Mandelson and Mr Brown is scarcely news; indeed, their rancorous history was part of what made the appointment seem so bold. Mr Osborne's big mistake, however, was failing to anticipate some of what happened next.

The press began probing Lord Mandelson's connections with Oleg Deripaska, a Russian metals magnate who was also on and around (in his yacht) Corfu in August. There were insinuations (denied) that this association might have affected European policy on aluminium tariffs. Then, on October 21st, Mr Osborne got burned. Nathaniel Rothschild, a financier at whose villa Mr Osborne stayed during part of his Corfu holiday, alleged in a letter to the *Times* that Mr Osborne and Andrew Feldman, the Conservative Party's chief executive, had solicited a donation from Mr Deripaska. The Tories, Mr Rothschild wrote, also discussed routing the cash via a British company to make it legal under party-funding laws. Mr Osborne maintained that the idea had been Mr Rothschild's, not his or Mr Feldman's—but implicitly conceded that they had talked about such a donation.

After a riot of counter-claims, other details in dispute include whether the proposal was mentioned on Mr Deripaska's yacht (which Mr Osborne visited twice, once with Mr Feldman). But another question is why, if he had been involved in Corfu conversations that were at best embarrassing and at worst career-ending, Mr Osborne drew attention to his sojourn there. The answer seems to be that he thought he was safe: Mr Rothschild is an old friend; his mother, Lady Rothschild, is a big supporter of the Tory Party in general and Mr Osborne in particular. So a further mystery is why Mr Rothschild attacked his chum. (The publicity has been unhelpful for Mr Deripaska, with whom Mr Rothschild has extensive business ties.) The official line is that Mr Rothschild, who is also friends with Lord Mandelson, was outraged by Mr Osborne's indiscretion. The involvement and perhaps displeasure of the Murdoch media clan may be a factor: some of the Corfu

festivities were to celebrate Elisabeth Murdoch's birthday.

Cui bono?

Any tale that enables journalists to deploy the words "Ionian", "scion", "oligarch", "Murdoch" and "infinity swimming pool" inevitably fascinates, especially in a period dominated by the depressing lexicon of "bail-out", "Keynes" and "recession". In the end, say the Tories, the furore is a mere distraction, because no money actually changed hands. Yet the story involves two of the most cunning and important figures in British politics. Whoever said what to whom, in whatever order and on whoever's yacht or terrace, the affair does matter, for three reasons.

The first involves rich Russians and their efforts to launder their reputations—and the willingness of politicians of all stripes to collude with them. Like his better-known associate Roman Abramovich, Mr Deripaska was close to Boris Yeltsin, has kept on the right side of Vladimir Putin and wants to be liked. But he acquired much of his astronomical wealth—before the credit crunch, at least, he was reckoned Russia's richest man—in the wake of the Siberian "aluminium wars" of the 1990s. His American visa was recently revoked. As with many of the other oligarchs, worries about his past conduct and his intimacy with the Kremlin make him an unsuitable pal for high-ranking politicians. It is grossly naive for any of them to think otherwise.

Next, the danger for the Tories. The risk for them probably does not lie in the specific allegations about fund-raising, which these days bounce off voters like water off a landing craft's propellers. Rather it lurks in the now-republished photos of Mr Osborne in the Fauntleroy outfit of the Bullingdon club, a toffy Oxford society of which he was a member at the same time as Mr Rothschild (and of which David Cameron, the Tory leader, is also an alumnus). The danger lies, in other words, in the freshly glaring poshness of the Tory elite. As recession bites, unemployment rises and repossessions mount, the sort of privilege that the Corfu saga seems to advertise may become a bigger liability than it has hitherto seemed. The Tory high command has started to look like a leisure class instead of an officer class.

For Mr Osborne himself, this is an especially bad time to be conjoined in the headlines with billionaires and yachts. Many, including some in his own party, feel his performance during the financial crisis has been weak. The Deripaska episode epitomises what some regard as his biggest flaw: though clever, he is sometimes impetuous and a compulsive political game-player.

The third lesson concerns Lord Mandelson. The "new Tories" have long admired him for his role in creating new Labour and his suppleness as a strategist: there may perhaps have been a faintly Oedipal motive in Mr Osborne's bid to compromise him. The business secretary evidently retained his wiles through his Brussels exile, and nurtured a formidable network of allies. Lord Mandelson is still dangerous (including to himself).

And Mr Osborne will not be the only figure to have learnt that lesson. Those inside the cabinet who resent Lord Mandelson's resurrection and disagree with his pro-business views have taken note, and most will think at least twice before tangling with him. The battle of Corfu has left Lord Mandelson stronger.




The anti-West

An axis in need of oiling

Oct 23rd 2008
From The Economist print edition

Russia, Iran and Venezuela have been making common cause. A plunging oil price may stay their hand, but the West should still watch out

Illustration by Claudio Munoz



IT WAS one of George Bush's catchier turns of phrase—the "axis of evil" consisting of North Korea, Iran and Iraq. How evil, or even menacing, they really were is debatable. And it was not much of an axis: Iran and Iraq hated each other. North Korea exported nuclear know-how, but probably no more than other countries such as Pakistan, a supposed American ally.

Of late another trio, bound together by dislike for America, and confidence based on surging energy revenues, has appeared: an "axis of diesel", as some have named it, comprising Russia, Iran and Venezuela. At least before the present financial crisis, the trio had been hobnobbing happily. Russia has sold billions of dollars' worth of arms to Venezuela and blocked Western attempts to slap tougher sanctions on Iran. The Kremlin is also selling air-defence systems to the Iranians.

Yet in this case, too, the idea of an "axis" is exaggerated. Each of the trio has different aims. Venezuela wants to create an anti-American block in Latin America. Russia likes the idea of challenging the United States in its backyard: a suitable response to what it sees as American meddling in Russia's own neighbourhood, where its president, Dmitry Medvedev, claims "privileged interests". But Russia's backing for Venezuela is constrained by its ties to other countries in the region, such as Brazil.

Similarly, Russia likes to play the "Iran card", signalling to Mr Bush that he may have to give ground in, say, Georgia if he wants help in the Middle East. But as far as any outsider can say, the Kremlin does not want Iran to have a bomb.

So the common interests of the three countries are mostly tactical, not strategic. The same applies to China, which is a co-founder, along with Russia, of the Shanghai Co-operation Organisation, a loose security club. Having snubbed Russia over Georgia, China's top priority is not gloating or spoiling, but salvaging the world economy, including that of America, which is a crucial outlet for its goods.

The "diesel" trio did gloat at first over the West's meltdown. But they overlooked one of its effects: a plunge in oil prices, and hence their own revenues. This unwelcome news is likely to sharpen distinctions between them. Fyodor Lukyanov, a Russian foreign-policy pundit, says his country will have to prioritise. "Trying to achieve everything won't fly any more." The focus, he thinks, will be more on nearby countries and less on Latin America, not least because Venezuela will have less cash to buy Russian weaponry.

Indeed, the end of the oil boom may spell doom for that country's populist leader, Hugo Chávez. Oil has been his political oxygen. When he took office in 1998 the price was $11 a barrel. It peaked in July at $147. Since then it has halved. Oil accounts for 90% of exports and more than half of government revenues. At home it has paid for what he calls "21st century socialism": chiefly a torrent of central government spending, up from 22% of GDP in 2001 to 32% now. Mr Chávez also spends freely from the off-budget National Development Fund (Fonden), while Petróleos de Venezuela (PDVSA), the state oil company, has been required to divert part of its investment budget to social spending.

Oil has also financed an anti-American alliance. More than a dozen countries in Central America and the Caribbean receive a total of some 300,000 barrels per day (b/d) of Venezuelan oil on easy terms (of which 93,000 b/d go to Cuba). Venezuela has spent heavily to support Bolivia's Evo Morales, Nicaragua's Daniel Ortega and the opposition FMLN in El Salvador.

The price of cold turkey

For each $10 drop in the oil price, the government gets $5 billion (1.4% of GDP) less in revenue, according to LatinSource, a consultancy. Mr Chávez said this month that an oil price no lower than $80 was "sufficient". But the economy is already deteriorating. Oil-dependency has risen; nationalisation, bullying and meddling have deterred private investment; a fixed and overvalued exchange rate has stoked imports. In 2006 growth was 10.3% and inflation 17%; the latest growth figure is a 7.1%; inflation is 36%. Foreign debt is up from $30 billion to $44 billion. The cost of credit has risen. Opaque statistics make it hard to gauge Mr Chávez's room for manoeuvre. Fonden may contain some $15 billion; central bank reserves are about $27 billion. But the underlying trend is clear.

A devaluation risks setting off a downward spiral of inflation and rising poverty. As Mr Chávez scales back spending he will have to choose between losing influence abroad or losing popularity at home. Already he has quietly cancelled a promise to build an oil refinery in Nicaragua.

On the face of things, Russia looks better placed than its two friends to resist shocks; before the turmoil, it had built up the world's third-biggest stash of currency, at more than $500 billion. However, the Kremlin has been spending heavily to prop up the rouble, bail out banks and plug holes in its budget. Apart from falling oil prices, a big cloud on the Russian horizon is falling oil output, a trend that looks hard to reverse without massive investment—and there are many other things Russia has pledged to invest in, from an expanding military to its own creaky infrastructure.

Compared with Mr Putin, Mr Chávez is less involved in the global financial markets and even more prone to blame everything on an American-driven fiasco. "There's a spectre going round the developed world that was of its own making," he said this month. "Like Frankenstein [sic]…it went around the world and then went back to his maker." The first test of whom Venezuelans blame will come in local and state elections on November 23rd.

Thanks to sanctions, Iran is the axis member least exposed to the world economy. But the oil price fall will hit it hard. Some 80% of Iran's government revenues come from energy. A drop in income is unlikely to make Iran slow down its nuclear programme, or end support for Israel's armed foes. The nuclear efforts date back 20 years, predating the oil-price rise. But a sagging oil price will hurt the domestic economy and compound the woes of President Mahmoud Ahmadinejad.

Unlike Russia, which had prepared for a rainy day, Mr Ahmadinejad has been investing Iran's oil money in a different future: his own. Energy subsidies alone are about 12% of Iran's GDP; and energy revenues prop up the government budget. Inflation is at least 30%, up from an official 20% in February. The former central bank chief, sacked for resisting populist spending policies, has accused Mr Ahmadinejad of "looting" the bank's assets. Merchants recently went on strike in several cities, including Tehran, over higher sales taxes.

Even before the oil price fell, some senior Iranians had criticised Mr Ahmadinejad for stoking confrontation with the West and making it easier for the United Nations to impose sanctions. Yet a falling oil price puts more pressure on Iran's economy at a stroke than have several years of international sanctions.

The main aim of the "diesel" countries will now be to try to prop up falling prices. Iran and Venezuela, both members of the Organisation of the Petroleum Exporting Countries (OPEC), have called for it to cut output. Iran's energy minister insisted defiantly this week that "the era of cheap oil is finished." The

cartel’s members are sufficiently worried about the falling price to have brought forward their next meeting by three weeks, to October 24th.

But Saudi Arabia, OPEC’s biggest producer, which would be responsible for the biggest share of any reduction in output, has not yet endorsed the idea of a cut and will not want to do all the cutting itself. It can withstand lower prices better than most, since it can balance its budget at an oil price of just $49 a barrel, according to the IMF. Iran and Venezuela, by contrast, need about $95 to make ends meet, according to Deutsche Bank.

Those fiscal straits will make Iran and Venezuela reluctant to forgo revenue by making cuts of their own, setting the stage for a row over quotas with Saudi Arabia. Yet the Saudis will not be unhappy to see Iran, a regional rival, squirm. What is more, says Leo Drollas of the Centre for Global Energy Studies, a consultancy, they are unlikely to agree to big cuts for fear of further blighting the world economy. There is also the question of whether the cartel will stick to whatever agreement it reaches. In the past, cash-strapped members have frequently cheated.

In sum, Iran, Russia and Venezuela are all likely to be left short of cash—and facing a diminution in their international clout. “Never confuse brilliance with a bull market,” goes a Wall Street saying. The leaders of the oily trio may have thought high oil prices were an adequate substitute for good governance. In many quarters, the difference is now painfully clear.

Endangered languages

When nobody understands

Oct 23rd 2008
From The Economist print edition

The electronic age drives some languages out of existence, but can help save others

AP



Marie Smith: no one to talk to

THINK of the solitude felt by Marie Smith before she died earlier this year in her native Alaska, at 89. She was the last person who knew the language of the Eyak people as a mother-tongue. Or imagine Ned Mandrell, who died in 1974—he was the last native speaker of Manx, similar to Irish and Scots Gaelic. Both these people had the comfort of being surrounded, some of the time, by enthusiasts who knew something precious was vanishing and tried to record and learn whatever they could of a vanishing tongue. In remote parts of the world, dozens more people are on the point of taking to their graves a system of communication that will never be recorded or reconstructed.

Does it matter? Plenty of languages—among them Akkadian, Etruscan, Tangut and Chibcha—have gone the way of the dodo, without causing much trouble to posterity. Should anyone lose sleep over the fact that many tongues—from Manchu (spoken in China) to Hua (Botswana) and Gwich'in (Alaska)—are in danger of suffering a similar fate?

Compared with groups who lobby to save animals or trees, campaigners who lobby to preserve languages are themselves a rare breed. But they are trying both to mitigate and publicise an alarming acceleration in the rate at which languages are vanishing. Of some 6,900 tongues spoken in the world today, some 50% to 90% could be gone by the end of the century. In Africa, at least 300 languages are in near-term danger, and 200 more have died recently or are on the verge of death. Some 145 languages are threatened in East and South-East Asia.

Some languages, even robust ones, face an obvious threat in the shape of a political power bent on imposing a majority tongue. A youngster in any part of the Soviet Union soon realised that whatever you spoke at home, mastering Russian was the key to success; citizens of China, including Tibetan ones, face similar pressure to focus on Mandarin, the main Chinese dialect.

Nor did English reach its present global status without ruthless tactics. In years past, Americans, Canadians and Australians took native children away from their families to be raised at boarding schools where English rules. In all the Celtic fringes of the British Isles there are bitter memories of children being punished for speaking the wrong language.

But in an age of mass communications, the threats to linguistic diversity are less draconian and more spontaneous. Parents stop using traditional tongues, thinking it will be better for their children to grow up using a dominant language (such as Swahili in East Africa) or a global one (such as English, Mandarin or Spanish). And even if parents try to keep the old speech alive, their efforts can be doomed by films and computer games.

The result is a growing list of tongues spoken only by white-haired elders. A book* edited by Peter Austin, an Australian linguist, gives some examples: Njerep, one of 31 endangered languages counted in Cameroon, reportedly has only four speakers left, all over 60. The valleys of the Caucasus used to be a paradise for linguists in search of unusual syntax, but Ubykh, one of the region's baffling tongues, officially expired in 1992.

The effort to keep languages alive can lead to hard arguments, especially where limited funds are available to spend on education and official communications. In both America and Britain, some feel that, whatever people speak at home, priority should go to making sure that children know English well.

But supporters of linguistic diversity make strong arguments too. Nicholas Ostler, a scholar who heads the Foundation for Endangered Languages, a non-profit group based in Britain, says multilingual children do better academically than monolingual ones. He rejects the notion that a common tongue helps to avoid war: think of Rwanda, Bosnia and Vietnam.

Mark Abler, a Canadian writer, says the protection of endangered species is closely linked to the preservation of tongues. On a recent expedition in Australia, a rare turtle was found to have two varieties; a dying but rich native language, Gagudju, had different words for each kind.

Thanks to electronics, saviours of languages have better tools than ever before; words and sounds can easily be posted on the internet. Educational techniques are improving, too. In New Zealand Maori-speakers have formed “language nests”, in which grandparents coach toddlers in the old tongue. Australia’s dying Kamilaroi language was boosted by pop songs teenagers liked. But whatever tricks or technology are used, the only test of a language’s viability is everyday life. “The way to save languages is to speak them,” says Mr Austin. “People have to talk to people.”

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*“One Thousand Languages: Living, Endangered and Lost,” edited by Peter K. Austin. University of California Press (2008).



The weight of history

Oct 23rd 2008 | JERUSALEM AND ROME
From The Economist print edition

A relationship dogged by different views of the past

EIGHT years ago, when Pope John Paul II prayed at Jerusalem's Western Wall, there seemed to be a new level of trust between Roman Catholics and Jews. But so heavy is the historical baggage that the relationship still creaks under the strain.

The latest problem is a nasty flare-up in an old argument over the role of Pius XII, who was pope during the second world war. Was he a hero who deserves to be beatified, or was he, as some Jews say, guilty of neglectful silence?

On October 19th Shimon Peres, Israel's 85-year-old president, tried to draw a line under the row. "We have reason to believe that Pius XII didn't do enough to save Jewish life," he said, speaking for many Israelis. But he added: "I don't want to pass judgment. We don't want to make false accusations. If there is evidence [that he helped persecuted Jews] then it should be checked carefully." And he reissued Israel's invitation to the present pope, Benedict XVI. "The visit to the holy country is nothing to do with anger or disputes. It's holy all the time, it is holy for all of us."

The Vatican tried to cool things too. Its spokesman, Father Federico Lombardi, said on October 18th that a plaque criticising Pius XII at the Yad Vashem Holocaust Memorial in Jerusalem would not be "the determining factor" deciding a papal visit to Israel. This, in effect, overruled an assertion by Peter Gumpel, a cleric who heads the effort to get Pius XII beatified, that Benedict would not go to Israel until the plaque was removed.

The flare-up began when the Vatican, in what was meant as a friendly gesture, invited an Israeli rabbi to address the Synod of Bishops convening in Rome to discuss the teaching of the Hebrew scriptures. Rabbi Shear-Yashuv Cohen discovered too late that his trip coincided with ceremonies marking the 50th anniversary of Pius XII's death. "We cannot forgive or forget," the rabbi told the bishops, in an oblique reference to the pope. He also told journalists the pope should have done more to save Jews. The Vatican responded that this was a "black legend".

The arguments go back more than 40 years. Writers in the 1960s, most famously Rolf Hochhuth in his 1963 play "The Representative", condemned Pius XII for passivity and pusillanimity. The reading was reinforced in John Cornwell's best-selling "Hitler's Pope" (1999). But Mr Cornwell himself retracted many of his allegations after criticism. The Vatican archives, meanwhile, hardly helped the pope's case by refusing, for technical reasons, to open critical diplomatic files to scholars.

Still, historians are reassessing the record. Sir Martin Gilbert, official biographer of Churchill, who is a Jew and an authority on the Holocaust, has said that Pius XII, far from deserving obloquy, should be a candidate for Yad Vashem's order of "righteous Gentiles".

The Vatican's beatification process, now 26 years old, has been an incessant source of friction between the Vatican and Israel. But so has Israel's failure to fulfil parts of the "fundamental agreement" of 1993 in which the Holy See recognised the Jewish state. Israel vowed to give special status to the Catholic clergy in the Holy Land and to grant tax relief to church institutions; but disputes between government departments have blocked these measures. "We promised to negotiate in good faith for two years," says Rabbi David Rosen, an expert on Jewish-Catholic relations. "Instead we've negotiated in bad faith for 15 years."

Such spats may cloud a papal visit. Even harder for Benedict would be walking a line between the Fatah-led Palestinian Authority and the Hamas rulers of Gaza. But Mr Peres, for one, is sure the pope will act carefully over Pius XII: "I know [Benedict]…I am sure he will delve into the details…and study the history so that, at the end of the day, we can all live with the facts and the conclusions."



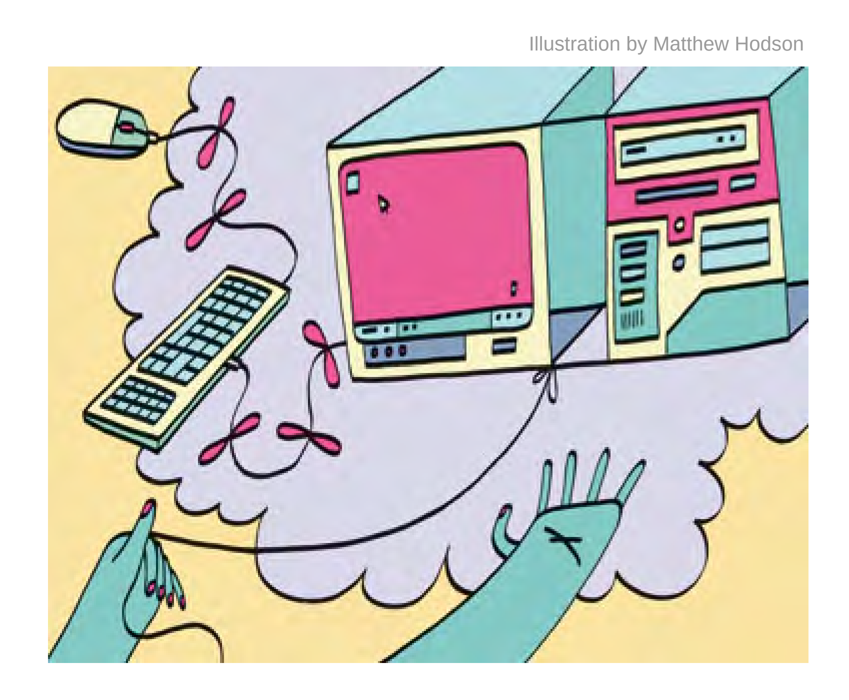
SPECIAL REPORTS

Let it rise

Oct 23rd 2008
From The Economist print edition

Information technology is turning into a global "cloud" accessible from anywhere, says Ludwig Siegele (interviewed here). What does that mean for the way people conduct business?

Illustration by Matthew Hodson



IN THE beginning computers were human. Then they took the shape of metal boxes, filling entire rooms before becoming ever smaller and more widespread. Now they are evaporating altogether and becoming accessible from anywhere.

That is about as brief a history of computers as anyone can make it. The point is that they are much more than devices in a box or in a data centre. Computing has constantly changed shape and location—mainly as a result of new technology, but often also because of shifts in demand.

The first "computers" were indeed people. The word originally meant an individual who solved equations, often using a mechanical calculator. Hundreds of them were employed by big companies that needed to do a lot of number-crunching, such as aeroplane manufacturers. It was only around 1945 that the word came to describe machinery.

But even after that, computing kept undergoing mutations—or, in the jargon, platform shifts. The mainframe, the original computing platform, was dethroned by minicomputers, which in turn gave way to personal computers, which are now being pushed aside by hand-held devices and smartphones. With each step the architecture—the underlying structure of computing—became more distributed.

Now, this special report will argue, computing is taking on yet another new shape. It is becoming more centralised again as some of the activity moves into data centres. But more importantly, it is turning into what has come to be called a "cloud", or collections of clouds. Computing power will become more and more disembodied and will be consumed where and when it is needed.

The rise of the cloud is more than just another platform shift that gets geeks excited. It will undoubtedly transform the information technology (IT) industry, but it will also profoundly change the way people work and companies operate. It will allow digital technology to penetrate every nook and cranny of the economy and of society, creating some tricky political problems along the way.

Promise of heaven

Here we go again, you may think. In order to generate new demand, the maturing IT industry keeps creating new buzzwords, often with celestial connotations ("cyberspace", "blogosphere"), which suggest some kind of technological nirvana. The reality is much more down to earth.

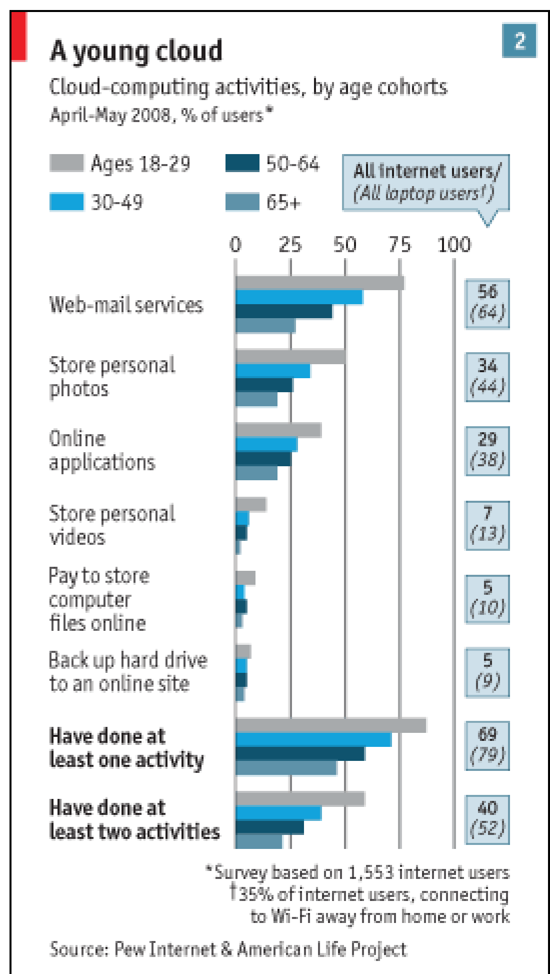
Hype is indeed rampant in "cloud computing". The term entered into IT-speak only a year ago and has spread voraciously. Cloud conferences and cloud blogs are multiplying almost as quickly as cloud start-ups. Established IT firms are slapping the new label on old gear.

Cumulonimbus 1
Cloud computing, average weekly search volumes
September average 2007=100
1,000
800
600
400
200
100
0
S O N D J F M A M J J A S
2007 2008
Source: Google Trends

In fact, the cloud craze may have peaked already, if the number of Google searches is any guide (see chart 1). Cloud computing is bound to go through a "trough of disillusionment", as Gartner, a research firm, calls the phase in the hype cycle when technologies fail to meet expectations and quickly cease to be fashionable. Much still needs to be invented for the computing sky to become truly cloudy.

Yet even if the term is already passé, the cloud itself is here to stay and to grow. It follows naturally from the combination of ever cheaper and more powerful processors with ever faster and more ubiquitous networks. As a result, data centres are becoming factories for computing services on an industrial scale; software is increasingly being delivered as an online service; and wireless networks connect more and more devices to such offerings.

All this allows computing to be disaggregated into components—or "services", in IT parlance. This is why European technologists such as Lutz Heuser, head of research at SAP, a German software giant, like to refer to it as the "internet of services". The cloud metaphor seems more apt. The internet is used mainly by people with personal computers and a physical network connection. Cloud applications, on the other hand, will be used by billions of devices of all kinds, many of them untethered, but will be connected to the "internet of things".



In some ways the cloud is already hanging in the sky, especially for consumers. According to a recent study, 69% of Americans connected to the web use some kind of "cloud service", including web-based e-mail or online data storage (see chart 2). The best example is Google, the biggest online search company by far, which now offers a plethora of web-based applications such as word-processing or online spreadsheets.

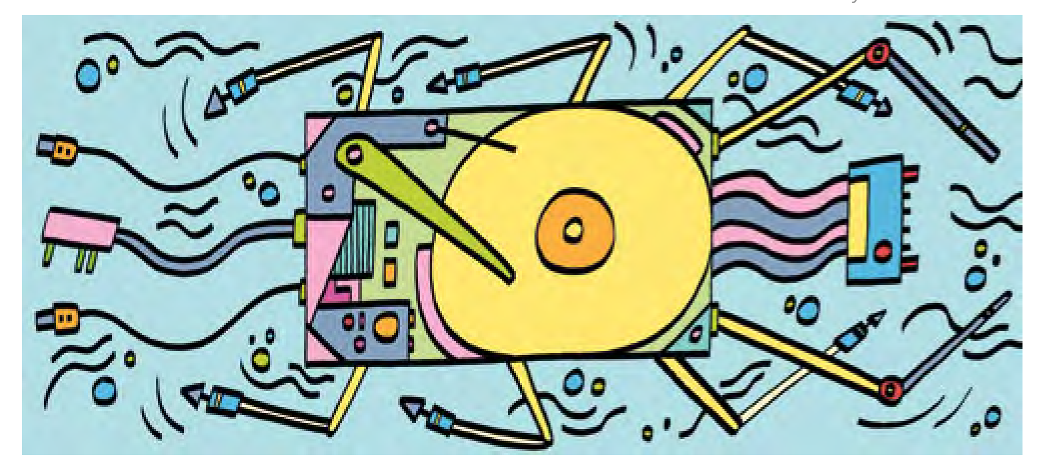
Learning to float

Companies, too, have been moving into the cloud, albeit much more cautiously. Financial institutions in particular have for some time been building "computing grids". Firms that provide enterprise software as a service (SaaS) over the internet, such as Salesforce.com and NetSuite, have been growing steadily.

In the years to come companies are likely to venture much farther. For one, operators of computing clouds such as Amazon and Google have shown that this is a far more efficient way of running IT systems. Secondly, many firms will find they have no choice. The way in which their IT infrastructure has grown is proving unsustainable. Most corporate data centres today are complex warrens of underused hardware that require more and more people, space and power to keep them going. The current economic malaise will increase the pressure on companies to become more efficient. More has to be done with less, which is

cloud computing's main promise.

Illustration by Matthew Hodson



This special report will chronicle the rise of the cloud and try to predict where it is heading. It will start by looking at the technology. Computing clouds are immensely complex, but can be roughly divided into three layers: infrastructure, applications and the periphery where they meet the real world. These will be discussed in turn. The report will go on to consider the impact the cloud will have on the IT industry and the economy as a whole. The conclusion will look at what might stop the cloud from growing ever thicker: regulation and worries about the safety of both personal and corporate data.

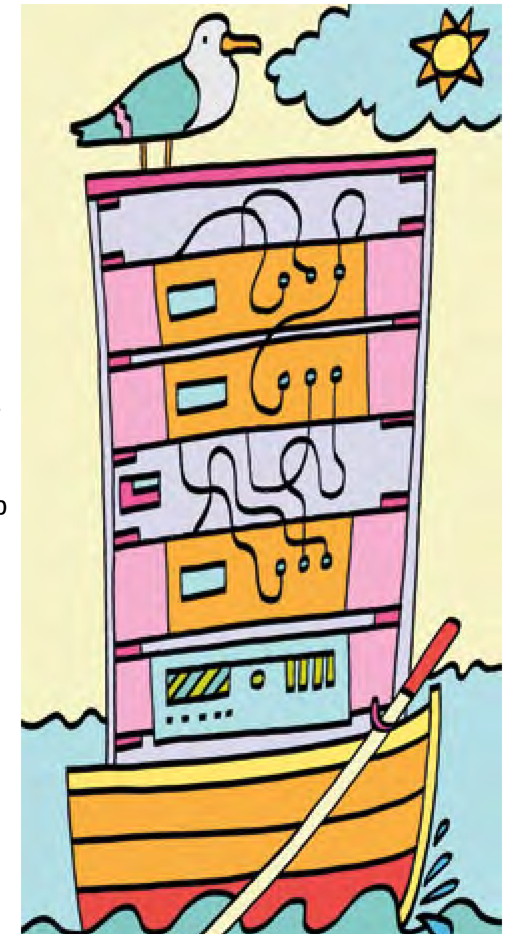
Irving Wladawsky-Berger, a technology visionary at IBM, compares cloud computing to the Cambrian explosion some 500m years ago when the rate of evolution speeded up, in part because the cell had been perfected and standardised, allowing evolution to build more complex organisms. Similarly, argues Mr Wladawsky-Berger, the IT industry spent much of its first few decades developing the basic components of computing. Now that these are essentially standardised, bigger and more diverse systems can emerge. "For computing to reach a higher level", he says, "its cells had to be commoditised."

Where the cloud meets the ground

Oct 23rd 2008
From The Economist print edition

Data centres are quickly evolving into service factories

Illustration by Matthew Hodson



IT IS almost as easy as plugging in a laser printer. Up to 2,500 servers—in essence, souped-up personal computers—are crammed into a 40-foot (13-metre) shipping container. A truck places the container inside a bare steel-and-concrete building. Workers quickly connect it to the electric grid, the computer network and a water supply for cooling. The necessary software is downloaded automatically. Within four days all the servers are ready to dish up videos, send e-mails or crunch a firm's customer data.

This is Microsoft's new data centre in Northlake, a suburb of Chicago, one of the world's most modern, biggest and most expensive, covering 500,000 square feet (46,000 square metres) and costing $500m. One day it will hold 400,000 servers. The entire first floor will be filled with 200 containers like this one. Michael Manos, the head of Microsoft's data centres, is really excited about these containers. They solve many of the problems that tend to crop up when putting up huge data centres: how to package and transport servers cheaply, how to limit their appetite for energy and how to install them only when they are needed to avoid leaving expensive assets idle.

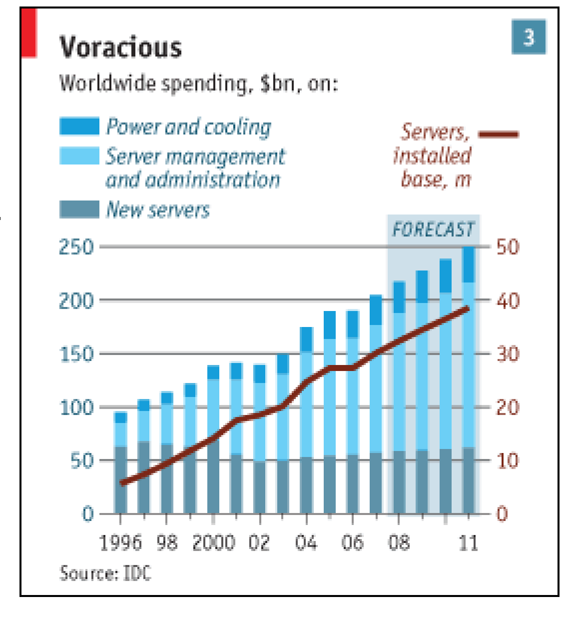
But containers are not the only innovation of which Mr Manos is proud. Microsoft's data centres in Chicago and across the world are equipped with software that tells him exactly how much power each application consumes and how much carbon it emits. "We're building a global information utility," he says.

Engineers must have spoken with similar passion when the first moving assembly lines were installed in car factories almost a century ago, and Microsoft's data centre in Northlake, just like Henry Ford's first large factory in Highland Park, Michigan, may one day be seen as a symbol of a new industrial era.

Before Ford revolutionised carmaking, automobiles were put together by teams of highly skilled craftsmen in custom-built workshops. Similarly, most corporate data centres today house armies of "systems administrators", the craftsmen of the information age. There are an estimated 7,000 such data centres in America alone, most of them one-off designs that have grown over the years, reflecting the history of both technology and the particular use to which it is being put. It is no surprise that they are egregiously inefficient. On average only 6% of server capacity is used, according to a study by McKinsey, a consultancy, and the Uptime Institute, a think-tank. Nearly 30% are no longer in use at all, but no one has bothered to remove them. Often nobody knows which application is running on which server. A widely used method to find out is: "Let's pull the plug and see who calls."

Limited technology and misplaced incentives are to blame. Windows, the most pervasive operating system used in data centres, allows only one application to run on any one server because otherwise it might crash. So IT departments just kept adding machines when new applications were needed, leading to a condition known as "server sprawl" (see chart 3). This made sense at the time: servers were cheap, and ever-rising electricity bills were generally charged to a company's facilities budget rather than to IT.

To understand the technology needed to industrialise data centres, it helps to look at the history of electricity. It was only after the widespread deployment of the "rotary converter", a device that transforms one kind of current into another, that different power plants and generators could be assembled into a universal grid. Similarly, a technology called "virtualisation" now allows physically separate computer systems to act as one.



Virtually new

The origins of virtualisation go back to the 1960s, when IBM developed the technology so that its customers could make better use of their mainframes. Yet it lingered in obscurity until VMware, now one of the world's biggest software firms, applied it to the commodity computers in today's data centres. It did that by developing a small program called hypervisor, a sort of electronic traffic cop that controls access to a computer's processor and memory. It allows servers to be split into several "virtual machines", each of which can run its own operating system and application.



"In a way, we're cleaning up Microsoft's sins," says Paul Maritz, VMware's boss and a Microsoft veteran, "and in doing so we're separating the computing workload from the hardware." Once computers have become more or less disembodied, all sorts of possibilities open up. Virtual machines can be fired up in minutes. They can be moved around while running, perhaps to concentrate them on one server to save energy. They can have an identical twin which takes over should the original fail. And they can be sold prepackaged as "virtual appliances".

VMware and its competitors, which now include Microsoft, hope eventually to turn a data centre—or even several of them—into a single pool of computing, storage and networking resources that can be allocated as needed. Such a "real-time infrastructure", as Thomas Bittman of Gartner calls it, is still years off. But the necessary software is starting to become available. In September, for instance, VMware launched a new "virtual data-centre operating system".

Perhaps surprisingly, it is Amazon, a big online retailer, that shows where things are heading. In 2006 it started offering a computing utility called Amazon Web Services (AWS). Anybody with a credit card can start, say, a virtual machine on Amazon's vast computer system to run an application, such as a web-based service. Developers can quickly add extra machines when needed and shut them down if there is no demand (which is why the utility is called Elastic Computing Cloud, or EC2). And the service is cheap: a virtual machine, for instance, starts at 10 cents per hour.

If Amazon has become a cloud-computing pioneer, it is because it sees itself as a technology company. As it branched out into more and more retail categories, it had to develop a sophisticated computing platform which it is now offering as a service for a fee. "Of course this has nothing to do with selling books," says Adam Selipsky, in charge of product management at AWS, "but it has a lot to do with the same technology we are using to sell books."

Yet Amazon is not the only big online company to offer the use of industrial-scale data centres. Google is said to be operating a global network of about three dozen data centres loaded with more than 2m servers (although it will not confirm this). Microsoft is investing billions and adding up to 35,000 servers a month. Other internet giants, such as Yahoo!, are also busy building huge server farms.

In some places this has led to a veritable data-centre construction boom. Half a dozen are being built in Quincy, a hamlet in the middle of America's Washington state, close to the Columbia River. The attraction is that its dams produce plenty of low-cost power, which apart from IT gear is the main input for these computing farms. On average, cooling takes as much power as computing. Microsoft's new data centre near Chicago, for instance, has three substations with a total capacity of 198MW, as much as a small aluminium smelter.

But cheap electricity is only one, albeit important, criterion for choosing the site of a data centre. Microsoft currently feeds 35 sets of data into an electronic map of the world, including internet connectivity, the availability of IT workers, even the air quality (dry air makes a good coolant), to see where conditions are favourable and which places should be avoided. Apparently Siberia comes out well.

Google, for its part, seems to be thinking of moving offshore. In August it applied for a patent for water-based data centres. “Computing centres are located on a ship or ships, anchored in a water body from which energy from natural motion of the water may be captured, and turned into electricity and/or pumping power for cooling pumps to carry heat away,” says the patent application.

Many chief information officers would love to take their IT infrastructure out to sea and perhaps drown it there. Even as demand for corporate computing continues to increase, IT budgets are being cut. At the same time many firms’ existing IT infrastructure is bursting at the seams. According to IDC, a market-research firm, a quarter of corporate data centres in America have run out of space for more servers. For others cooling has become a big constraint. And often utilities cannot provide the extra power needed for an expansion.

Fewer, bigger, better

So IDC thinks that many data centres will be consolidated and given a big makeover. The industry itself is taking the lead. For example, Hewlett-Packard (HP) used to have 85 data centres with 19,000 IT workers worldwide, but expects to cut this down to six facilities in America with just 8,000 employees by the end of this year, reducing its IT budget from 4% to 2% of revenue.

Other large organisations are following suit. Using VMware’s software, BT, a telecoms firm, has cut the number of servers in its 57 data centres across the world from 16,000 to 10,000 yet increased their workload. The US Marine Corps is reducing the number of its IT sites from 175 to about 100. Both organisations are also starting to build internal clouds so they can move applications around. Ever more firms are expected to start building similar in-house, or “private”, clouds. The current economic malaise may speed up this trend as companies strive to become more efficient.

But to what extent will companies outsource their computing to “public” clouds, such as Amazon’s? James Staten of Forrester Research, a market-research firm, says the economics are compelling, particularly for smaller firms. Cloud providers, he says, have more expertise in running data centres and benefit from a larger infrastructure. Yet many firms will not let company data float around in a public cloud where they could end up in the wrong hands. The conclusion of this report will consider the question of security in more detail.

It does not help that Amazon and Google recently made headlines with service interruptions. Few cloud providers today offer any assurances on things like continuity of service or security (called “service-level agreements”, or SLAs) or take on liability to back them up.

As a result, says Mr Staten, cloud computing has not yet moved much beyond the early-adopter phase, meaning that only a few of the bigger companies are using it, and then only for projects that do not critically affect their business. The *Washington Post*, for instance, used Amazon’s AWS to turn Hillary Clinton’s White House schedule during her husband’s time in office, with more than 17,000 pages, into a searchable database within 24 hours. NASDAQ uses it to power its service providing historical stockmarket information, called Market Replay.

Stefan van Overtveldt, the man in charge of transforming BT’s IT infrastructure, thinks that to attract more customers, service providers will have to offer “virtual private clouds”, fenced off within a public cloud. BT plans to offer these as a service for firms that quickly need extra capacity.

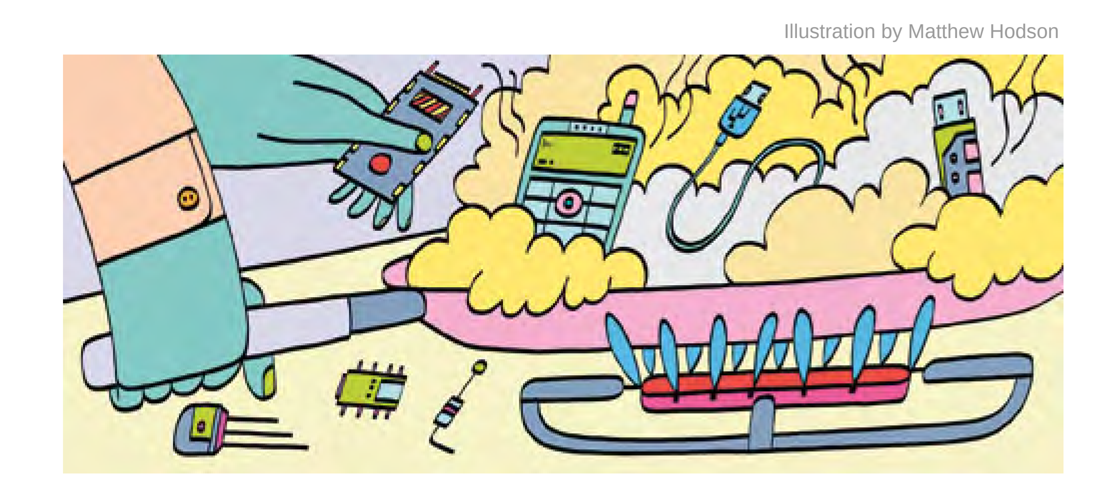
So there will be not just one cloud but a number of different sorts: private ones and public ones, which themselves will divide into general-purpose and specialised ones. Cisco, a leading maker of networking gear, is already talking of an “intercloud”, a federation of all kinds of clouds, in the same way that the internet is a network of networks. And all of those clouds will be full of applications and services.

Creating the cumulus

Oct 23rd 2008
From The Economist print edition

Software will be transformed into a combination of services

Illustration by Matthew Hodson



WANT to become a programmer in 20 minutes? With the program from Iceberg, a start-up, you can. Just open the "getting started wizard" and pick the type of application, say "project management". Type in its "business objects"—things like "client", "team" and "members"—and tell the tool how they relate to each other. Then design some input forms and define the process for getting a project done. Another click and you are ready to go.

In reality, of course, things are not that simple. And many professional programmers will scoff at the development tool as a mere toy. Yet Iceberg and similar outfits demonstrate that geeks are losing their monopoly on programming. Now, with a bit of patience, anybody can create a simple application, for instance, to collaborate with colleagues or to draw an online map.

This democratisation of programming, however, is only a small part of something much deeper: a fundamental change in the nature of software. It is not just that more and more software will become a service delivered online. More importantly, applications, web-based or not, will no longer come as a big chunk of software, but will be made up of a combination of electronic services—a shift that has picked up a lot of speed since computing began moving into the cloud.

To understand this new way of building applications, known as "service-oriented architecture" (SOA), think of a culinary analogy. Whereas the old chunk of software resembles a precooked meal that just has to be popped into the oven, the new architecture is more like a restaurant. It is a service in itself but also a combination of sub-services. There is the waiter who takes the order and conveys it to the kitchen. There is the cook who prepares the food. And there are the cleaners who keep the place tidy. Together they create the "application": a restaurant.

An attack of the vapours

The importance of this shift from a monolithic product to services is hard to overstate. In a sense, it has seeded the cloud, allowing the droplets—the services that make up the electronic vapour—to form. It will allow computing to expand in all directions and serve ever more users. The new architecture also helps the less technically minded to shape their own clouds, using such tools as Iceberg's.

Just as for the industrialisation of data centres, there is a historic precedent for this shift in architecture: the invention of movable type in the 15th century. At the time, printing itself was not a new idea. But it was Gutenberg and his collaborators who thought up the technologies needed to make printing available on a mass scale, creating letters made of metal that could be quickly assembled and re-used.

Similarly, the concept of modularity has been around since the early days of computing. “Everything in computer science is to just write less code. What is the technique for writing less code? It’s called subroutines,” said Bill Gates, Microsoft’s founder, in a recent interview. A subroutine is a part of a program that can be re-used, just like movable type. The idea, says Mr Gates, has always been to apply this principle of a subroutine more broadly.

Yet this did not happen, mainly because the cost of computing fell much faster than that of communications. Ever cheaper and more powerful chips made it possible to move from mainframes to minicomputers to personal computers (PCs) and now to hand-held devices. But connecting all these pieces remained difficult and expensive, which meant that such devices all had to come with their own data and chunky programs. Now, thanks to plenty of cheap bandwidth and more and more wireless connectivity, computing is able to regroup into specialised services, or Mr Gates’s subroutines: “We now live in a world where…[a] subroutine can exist on another computer across the internet.”

Part of Gutenberg’s genius was to recognise the need for all the letters to be identical in height so they could be easily combined. Similarly, for computing services to work there had to be robust technical standards. Only a few years ago this seemed far beyond the IT industry’s reach. Most firms insisted on their proprietary technology, mostly to lock in their customers. Again, cheaper communications helped to bring about change. The success of the internet demonstrated the huge benefits of open standards and forced vendors to agree on common ways for their wares to work together. One result is a stack of something called “web-services” standards.

Service-oriented architecture first showed up in open-source software but was quickly adopted by big enterprise-software vendors because they had a pressing need for it, says Jim Shepherd of AMR Research, a consultancy. Big software vendors, for instance, had to find a way to untangle the hairball of code that their products had become, or else they themselves would choke on it. Customers wanted more flexible and extensible programs.

Think back to the gastronomic example. A precooked meal is hard to change, and so are traditional software applications. By contrast, a restaurant can easily change its menu and its style of operation. Similarly, SOA-based software allows companies to alter their business processes, such as the way they handle orders to collect cash.

SAP, a German software firm, was one of the first companies to put this service-oriented architecture front and centre. Starting in 2003, it developed, among other things, a new corporate-software package that did away with monolithic applications, such as programs to keep track of a company’s finances or manage its relationship with customers. Instead, it introduced a collection of re-usable components that could be strung together at will.

IBM, too, is a fan of SOA and web services. But its approach is somewhat different, given that it does not sell business applications but makes most of its money from IT services and software to manage the underlying computing infrastructure. IBM uses SOA mainly to help firms integrate their increasingly complex and disparate IT systems. Its software turns them into a collection of services that can be woven into business processes.

The approaches may be different but the vision is the same: to create IT systems that adapt to the business needs of companies and allow them to connect. “When I want to do something new”, explains Steve Mills, the boss of IBM’s software group, “I do not need to build a new application but can use the pieces I already have.” To Peter Zencke, who led the development of SAP’s new package, its most exciting feature is that “any of the process components can now become a service provided by some other firm.”

Despite millions of dollars spent on marketing SOA, it has not really taken off yet. But many web-based applications for consumers rely on this concept. The prime example is Google Maps. When the online giant launched the service, programmers quickly figured out how to mix the maps with other sources of information. This is how, for example, Housingmaps.com was created, a combination of a Google map with the rental and sales listings from Craigslist, a website for classified ads. It was one of the first “mash-ups”, as such combinations have come to be called.

Since then the number of such mash-ups has exploded, thanks mainly to services like Microsoft’s Popfly and Yahoo! Pipes. In essence these are graphical programming tools. Users drag and drop “modules”—data feeds providing such information as pictures, headlines and search results—and weave them together.

Most of these mash-ups are still toys, but firms offering software as a service have started offering similar combinations. In April Salesforce.com and Google announced that they would integrate their online services. Users of Salesforce, which helps firms manage their customer relationships, can now quickly switch to Google's web-based applications.

Smaller firms have already started to weave a network of services. OpSource, a Silicon Valley start-up, for instance, provides basic services for other SaaS firms and web companies. TriCipher, another Californian newcomer, authenticates users of web applications. Ribbit, for its part, allows these services to add voice communications to their offerings.

Yet it is unlikely that the software cloud will end up as a vast nebula of thousands of specialised services. Even creating a service-oriented architecture is "no silver bullet" against complexity, in a famous phrase by Frederick Brooks, an elder of computer science. Although web services allow online offerings to connect, for instance, it is costly to synchronise their data. And it would not make sense for any firm to bet its business on simple mash-ups.

As software markets mature, they tend to form two kinds of clumps: integrated suites of applications, and platforms on top of which others can build programs. Both forms are already emerging. On the applications side there is Google Apps and Zoho, which is even more comprehensive. It encompasses a total of 18 applications, including word processing, project management and customer-relationship management (CRM).

As for platforms, there are already plenty, in different shapes and sizes. For enterprise applications, SAP has built one called Netweaver. Oracle offers something similar called Fusion. Last year, Salesforce launched a "platform as a service", allowing other firms to use the plumbing that supports its own CRM offering.

More recently platforms for consumer services have been proliferating. Facebook, a social network, was the first to become one in 2007. Other big online firms have followed suit or will do so soon: Google with App Engine, Yahoo! with Y!OS and Microsoft with a "cloud operating system" thought to be called Windows Strata. Some predict a platform war to rival the epic fights between Microsoft's Windows and Apple's Macintosh.

Never say die

What shape will the software cloud take, other than being a vast collection of services? In one way it will look much like the old software world. There will be a few big platforms, akin to today's operating systems, and most applications will be written to one of these platforms.

What is less clear is just how much of business and consumer software will migrate into the cloud, and how fast. The answer depends on whom you ask. Unsurprisingly, Marc Benioff, Salesforce's founder and chief executive, argues that web applications will spell the "death of software". But people are not about to throw out their powerful PCs or other "client" devices, if only because many of them still work offline at times. Similarly, companies will always want to keep some applications in-house, for reasons of security, regulation or simply to maintain control. Ray Ozzie, Microsoft's chief software architect, promotes something called "software plus services", meaning that customers will settle on "the right mix of old and new stuff".

If history is any guide, Mr Ozzie is more on the mark. Even the biggest changes in IT have never spelt the death of anything, notes Josh Greenbaum of Enterprise Applications Consulting. IBM, for instance, is still making money with mainframes.

So the software cloud, just like its hardware underpinnings, will be very diverse. But how will people make use of this kind of computing?

Economist.com SPECIAL REPORTS

On the periphery

Oct 23rd 2008
From The Economist print edition

The cloud's communications with its clients will become ever more intelligent and interactive

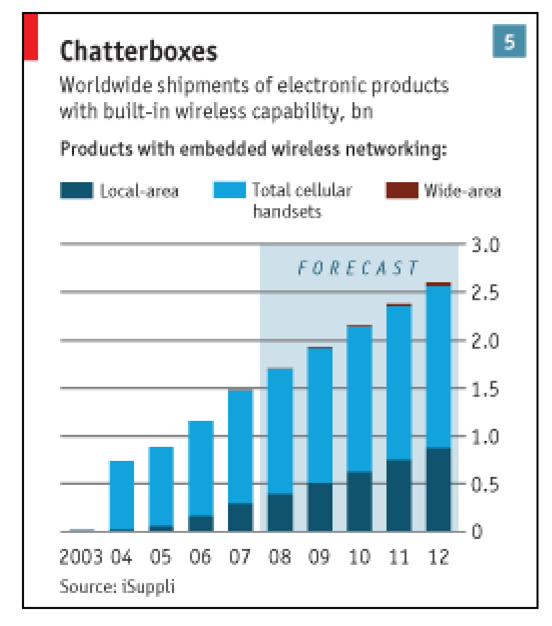
Illustration by Matthew Hodson



IT WILL take something with a lot more bang to replace a medium that is thousands of years old. That was the prevailing reaction when Amazon last November announced the launch of Kindle, an electronic book reader the size of a paperback that can store more than 200 volumes. Yet by the end of this year Amazon will have sold nearly 380,000 Kindles, says Mark Mahaney, an analyst with Citigroup, a bank. "Turns out the Kindle is becoming the iPod of the book world," he recently wrote in a note to clients, in a reference to Apple's iconic music player.

It is certainly not the Kindle's looks that explain its success. Compared with the iPod, its design looks very last century. Software and battery life, too, leave a lot to be desired. The chief attraction of the device is the ease with which it can be used to buy books and other content. Equipped with a mobile-phone modem, the Kindle can simply pull new reading material out of the air. Users do not even have to have a wireless service contract. "Our vision is to have every book that has ever been in print available in less than 60 seconds," explains Jeff Bezos, Amazon's boss.

It remains to be seen whether the Kindle will become a cultural phenomenon like the iPod, of which around 160m have been sold so far. Amazon, for its part, is downplaying the Kindle's success and will not confirm any sales estimates. But it is safe to say that, once the next generation of wireless networks is up and running, hundreds of millions of devices will come, like the Kindle, with built-in radio connectivity (see chart 5). Digital cameras will automatically upload pictures. Smart meters will send readings of how much electricity a house consumes. All kinds of sensors will be able to send messages, even things like dipsticks when tanks of liquid are low.



The relationship of these devices to cloud computing may not be obvious. But if huge data centres and applications make up the cloud itself, then all the hardware and software through which it connects and communicates with the real world are its periphery. In IT speak, this is known as the "front end" or "client side".

As the Kindle and other examples show, this layer does not have much to do with the user interface or client device of old. It will do a lot of computing itself. It will come in all shapes and sizes, depending on what the user wants to do.

And it will not just distribute information, as the web does, but collect it as well. The analogy that springs to mind here is a theatre performance with audience participation: the electronic cloud will adapt to whatever it engulfs.

As you like it

Just like computing itself, the dominant user interface has evolved continually. In the days of the mainframe, when computers and their peripherals filled entire rooms, people communicated with these machines first via punch cards and then via green-glowing monitors, which were simply dumb terminals. Only with the rise of personal computers did the user interface become more intelligent, responsive and graphical.

The first version of the web was thus a brief step backward. To be sure, browsers brought colour and graphics to the hitherto text-based internet, but they were as dumb as the mainframe terminal. This has changed only in recent years. A bundle of web-development techniques dubbed AJAX and multimedia software such as Adobe's Flash and Microsoft's Silverlight now allow programmers to write what are called "rich internet applications" (RIA).

Whatever the buzzword, the principle is much the same. Servers no longer dish up simple hypertext markup language (HTML), the web's early lingua franca. Increasingly, web pages are bona fide pieces of software that are executed in the browser. Users of Web 2.0 sites who venture into menu items such as "view source" in their browsers can sometimes see thousands of lines of code.

In recent months the browser has become even more of a platform for other programs, akin to an operating system such as Windows. The main driver of this trend is Google, with its huge strength in distribution that can only gain from more and more software being offered as a service. In May 2007 the Silicon Valley firm launched Gears, a program that allows web applications to be used offline, and in September this year it released a new browser called Chrome. Its most important feature is that it can execute several sophisticated web applications at once.

Although for now the internet browser will remain the main vehicle for people to interact with the cloud, other forms are coming to the fore. One is the "widget", a snippet of code that often lives on a PC's desktop and allows the user to get a quick personalised view of a set of data. The idea is that a salesperson, for instance, should not have to fire up an entire application for customer-relationship management to find out which leads to follow up.

More importantly, there is now a greater variety of hardware through which to access the cloud. Already, desktop and laptop computers are starting to lose their monopoly for surfing the web as smaller devices such as smart mobile phones and various forms of portable computers start to compete with them.

Asus, a Taiwanese computer-maker, started the trend when it launched a small, cheap laptop called "Eee" a year ago. Now there are dozens of these devices. Gartner reckons that 5.2m of these "mini-notebooks" will be sold this year, 8m next and as many as 50m in 2012.

Perhaps the best indicator of things to come is Intel, a huge chipmaker. It made a fortune selling processors for servers, personal computers and laptops. In June the firm launched a new line of chips called Atom, designed to power what it calls "netbooks" and "mobile internet devices" (MIDs), mainly intended for surfing the web. Intel is also the driving force behind WiMAX, a technology for wireless broadband access to the internet. It wants to put a WiMAX radio chip into as many devices as possible, from portable computers to specialised gadgets such as the Kindle.

Apple's iPhone and its App Store, which allows iPhone and iPod owners to download applications, also provide a foretaste of how important wireless devices will be for the cloud. Apple launched App Store only in July. Two months later it had already tallied 100m downloads, meaning that it took off much faster than Apple's highly successful iTunes music store. Many of the programs on offer connect to the cloud, including news feeds, multi-player games and a service that keeps track of the latest polls for America's presidential election.

You can take it with you

The plethora of devices wirelessly connected to the internet will speed up a shift that is already under way: from a “device-centric” to an “information-centric” world, in the words of VMware’s Paul Maritz. Up in the cloud there will be a body of data for each individual that will accompany them through life, he explains, and it will not be tied to any particular device, as it is today.

Again, what will make this possible is virtualisation—this time of client devices, not servers. With the help of software from VMware and others, some firms have already virtualised their employees’ desktop computers, which allows them to be managed centrally. Operating systems and applications will no longer run only on the employee’s PC but on a virtual machine in a data centre that can be accessed remotely, theoretically from any PC in the world. Sooner or later mobile devices will also become virtualised. Users will be able to use their applications and data on whichever gadget they have at hand.

Yet the cloud’s interface is designed not merely to provide information but to gather it as well. The future belongs to services that respond in real time to information provided either by their users or by non-human sensors, predicts Tim O’Reilly, the founder of O’Reilly Media, a publisher of technology books who coined the term “Web 2.0”. Such “live applications”, he says, will get better the more data they are able to collect—and there will be plenty as the cloud expands.

One of the first examples of such a service was Google. What originally put the search service ahead of the competition when it was launched a decade ago was its way of harvesting the information provided by web users in linking to other sites: the more links point to a page, the more useful it must be. These days most links are generated by computers, so the original form of this “page rank” algorithm has long since been scrapped. But Google’s approach is still the same: mining information provided by web users, such as their search histories, to provide more relevant search results and more effective and targeted advertising.

The direct link to users also allows firms such as Google continuously to improve their interface, something traditional software-makers were not able to do. At any given time Google is running dozens of tests to optimise the look and feel of its offerings. This makes web applications far less technology-driven and much more user-oriented, says IBM’s Mr Wladawsky-Berger. “They are much more inspired by what goes on in the real world.”

A raft of start-ups is also trying to build a business by observing its users, in effect turning them into human sensors. One is Wesabe (in which Mr O’Reilly has invested). At first sight it looks much like any personal-finance site that allows users to see their bank account and credit-card information in one place. But behind the scenes the service is also sifting through its members’ anonymised data to find patterns and to offer recommendations for future transactions based, for instance, on how much a particular customer regularly spends in a supermarket. Wireless devices, too, will increasingly become sensors that feed into the cloud and adapt to new information.

Nokia, for its part, is planning to build all kinds of sensors into mobile phones to monitor things like movement, barometric pressure or even the owner’s health, which many experts expect to become a big new trend. Sensors could also be used to record people’s activities, creating what some already term a “lifelog”—raising all kinds of privacy concerns.

As wireless technology gets better and cheaper, more and more different kinds of objects will connect directly to the cloud. SAP, the German software-maker, has launched a research project called “The Internet of Things” to see what can be done with the resulting information. As part of that project, an initiative called the “Future Factory” is now under way to investigate how intelligent tags can make manufacturing more adaptive and efficient.

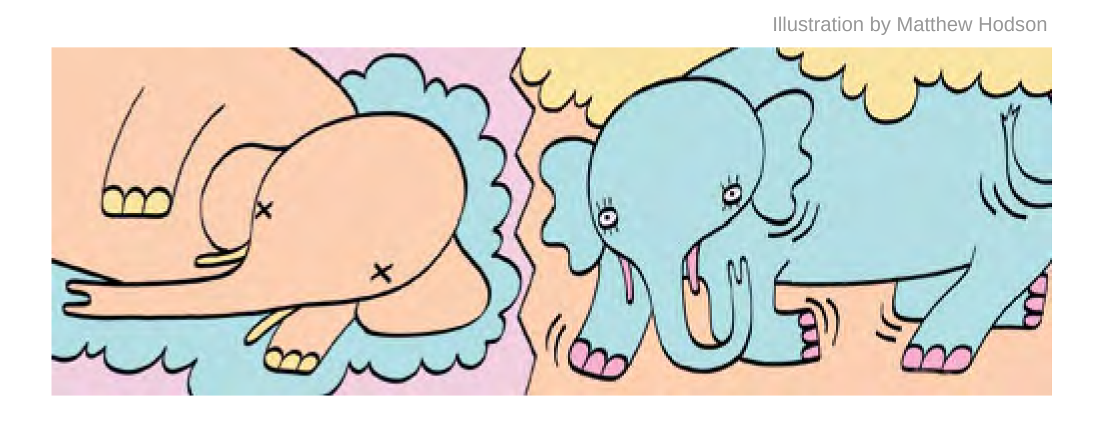
More and more data get you only so far, however. In the end, Google’s search results and its text-based online advertisements are relevant to users only because the firm has devised clever ways to sift through them, says Hal Varian, the firm’s chief economist. The big challenge of the cloud will be to connect the myriad data in it and make them profitable.

Highs and lows

Oct 23rd 2008
From The Economist print edition

As IT gets cloudier, the economics of the business will change

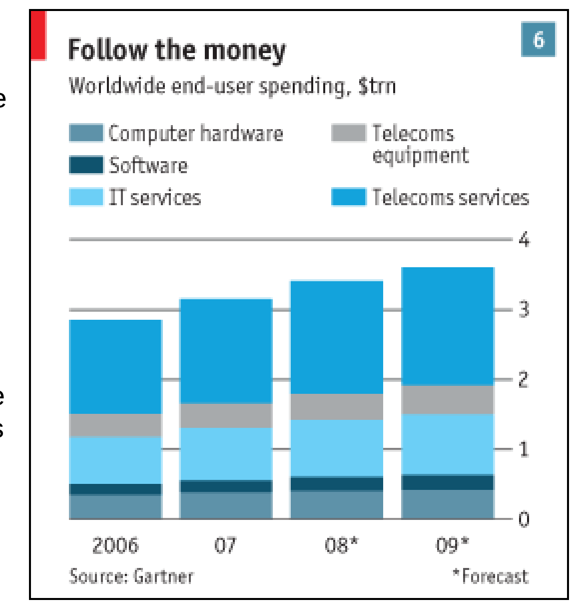
Illustration by Matthew Hodson



EVEN elephants can die. In 1993 extinction came close for IBM, then the world's largest computer-maker (it has since been overtaken by HP). Its mainframe business was collapsing and profits were plummeting. At that point Louis Gerstner took over as chief executive and managed to turn the company around. "Only a handful of people understand how precariously close IBM came to running out of cash in 1993," he writes in his memoir, "Who Says Elephants Can't Dance?" "Whether we would have had to file for bankruptcy, I can't say."

There are many reasons why IBM nearly went belly-up, not least the fact that Big Blue had become a bureaucratic monster. But most critically, it had failed to adapt to the industry's first big platform shift, which only really made itself felt in the early 1990s: the move from mainframes to smaller machines, first so-called minicomputers, then personal computers. "IBM was slow, very slow, in delivering distributed computing, and many small companies moved in to fill the gap," Mr Gerstner writes.

It is unlikely that the move into the cloud will produce a similar near-death experience or even a real casualty—if only because IBM still stands as a warning. But that does not mean that the structure of the IT industry will remain unchanged, nor that the economics will stay the same. Once the IT sky really clouds over, individual firms' share of the global IT budget (see chart 6) will shift.



The move to distributed computing, which started in the mid-1980s, led to a big change in the IT industry. In the era of the mainframe computing came in a vertically integrated package, mainly from IBM. With distributed computing the industry became a stack of horizontal layers. In corporate IT these were mainly hardware, the network, infrastructure software (such as operating systems and databases), enterprise applications and IT services.

Not all of these layers were created equal. Computer-makers commanded a thicker one, for instance, but software companies were more profitable. The key program was the operating system, both on servers and on personal computers ("clients"). It was the standard to which other components of IT systems had to conform. Usually this was a version of Windows, which made Microsoft the IBM of this new era of computing.

Cloud computing is unlikely to bring about quite such a dramatic shift. In essence, what it does is take the idea of distributed computing a step farther. Still, it will add a couple of layers to the IT stack. One is made up of the cloud providers, such as Amazon and Google. The other is software that helps firms to

turn their IT infrastructure into their own cloud, known as a “virtual operating system for data centres”.

Drawing a neat diagram of the IT stack will also become increasingly difficult because the layers are becoming less distinct. In a world of services it often does not make sense to think of hardware and software separately, argues Padmasree Warrior, the chief technology officer of Cisco. Both need to be blended to offer new services, she says.

Mix and match

Even though the IT stack may not change all that much, the perceived value of the different layers will shift, and with it the amount of profit IT firms can make from each of them. Who will lose and who will win depends on how much of computing eventually moves into the cloud.

In the first round almost everybody in the IT industry will do well as the clouds are being built. The biggest winners are likely to be hardware-makers, says Mark Stahlman of Gartner: “Hardware always wins when new demand for computing is uncovered. And we haven’t had such a sweeping global demand since the 1990s.”

But in the longer term there will be relative winners and losers. The hardware business could actually find itself in the losing group. Its margins could get squeezed as cloud computing matures because there will be fewer customers with more buying power, says James Staten of Forrester Research. Large cloud providers can dictate how to build servers and at what price, he notes.

All that may explain why hardware-makers were among the first to jump on the cloud-computing bandwagon. So far, they have done only what Mr Staten calls “cloud-washing”: relabelling existing products that help customers build a more flexible IT infrastructure. But they are also preparing for a time when more money can be made building clouds than building computers. IBM and HP, for instance, have teamed up with other firms and universities to design new cloud architectures.

Which side of the fence?

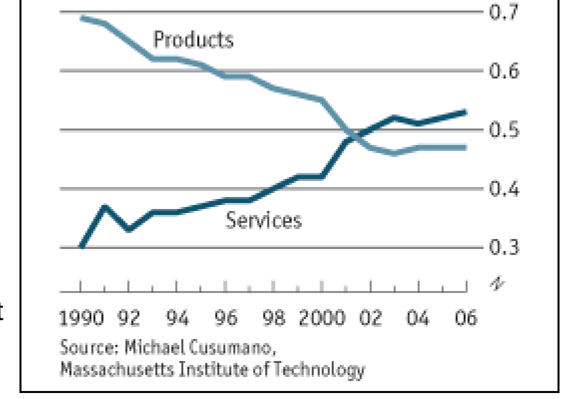
In the long run, says Mr Staten, hardware-makers may be torn between supplying cloud providers or becoming providers themselves. Being both will not be easy, because the firms would be competing with their biggest customers. Dell seems to have decided to be a cloud supplier. Sun Microsystems is a candidate to become a provider; it is offering a cloud-like service called Network.com, albeit not very successfully. HP and IBM, already used to the balancing act of selling hardware and providing IT services, will try to do both.

Makers of traditional software will find the going even tougher. With the advent of open-source software, in particular Linux, selling operating systems had already become less profitable. In a virtual world they will become even more commoditised, which is bad news for Microsoft. Many business applications no longer need a big, general-purpose server operating system but can use a specialised one, which should put pressure on prices. On client computers, more and more applications are written to run in browsers, not on any particular operating system.

Makers of business applications are also on the defensive. Traditionally they have made billions by selling their programs, often demanding hefty sums to install them and then charging an annual maintenance fee for upgrades and technical support. But this highly lucrative business model has come under increasing pressure, says Michael Cusumano, a professor at the Massachusetts Institute of Technology (MIT).

For one, he says, software vendors will have to find new ways to charge for their wares: in the cloud, tying licensing fees to the number of users, for instance, will be difficult, since services will mostly be consumed by other machines. More importantly, the corporate world has become less and less willing to buy software for large sums of money, so software firms listed on America’s stockmarkets now make most of their profits from maintenance and other services (see chart 7). SAP will increase its annual maintenance fees to at least 22% of a

program's value over the next few years, in line with those of Oracle, its main rival.



Yet the biggest challenge for software firms is to become providers of online services themselves, says Brent Thill of Citi Investment Research. So far they have moved slowly, offering SaaS only on the side, if at all. This was partly because their customers were not that keen. But more importantly, notes Mr Thill, the software houses are still wedded to their old business model. With SaaS they do not get a big upfront payment, only subscription fees.

Once Salesforce and NetSuite had shown that the SaaS model works, the incumbents began to move faster. In September last year, for instance, SAP presented "Business ByDesign", a package of web-based enterprise applications for smaller businesses. But success will not come easily. SAP has slowed down the introduction of the new service because it still needs to work out how to run it cheaply enough to make a reasonable profit.

Pure SaaS providers also have a lot on their minds. Some experts, such as Joshua Greenbaum of Enterprise Applications Consulting, reckon that few will ever be as profitable as traditional software firms. Although it is almost a decade old, Salesforce started making money only in 2006, mainly because it first had to spend heavily on marketing to attract customers. But now that the service has 1m users and revenues of more than $1 billion, these costs will come down, says the firm.

The companies that have the best chance of making money from the cloud are those that get things to connect and work together and help customers move their computing around. This is music to the ears of big IT firms, not least IBM. Nearly 80% of its revenues come from infrastructure software and IT services, which it can offer globally. HP is catching up, having taken over EDS, another big IT-services firm. Both Microsoft and SAP, for their part, believe that firms will want to have a choice in where to do their computing, as well as the flexibility to move things around over time.

Two potentially important contestants are rarely mentioned: Cisco and EMC, the leading makers of networking and storage gear respectively. Having invested a lot in software and services, Cisco has become more than just the source of most of the world's routers, the traffic cops of the internet. It is betting that in the cloud the network layer will become more important, for instance to ensure that computing workloads are able to move around securely. EMC, for its part, has made two dozen cloud-related investments and launched a cloud-infrastructure division.

Whoever manages to own the dominant operating system for the data centre could become a big winner. VMware is bound to have a shot at this. As well as being the market leader in virtualisation, it has the support of EMC, which holds 86% of the firm. But the competition is likely to be intense.

Will this prospective platform war produce a dominant company in the mould of IBM or Microsoft that is able to extract more than its fair share of the profits? Probably not, because it will be relatively easy to switch between vendors, says George Gilbert of Tech Strategy Partners, a consultancy. Nor is it likely that one firm will manage to build a global cloud monopoly. Although there are important economies of scale in building a network of data centres, the computing needs of companies and consumers vary too widely for one size to fit all.

Even if the cloud is likely to transform the IT industry, some things will stay the same. One is the importance of lock-in. If anything, companies and developers will be even more dependent on cloud platforms and applications than they are on the old kind. SaaS promotes the "hollowing out" of IT: a firm that needs to migrate to another system will no longer have the required expertise. When Facebook, say, makes a change to its platform, developers have no choice but to go along with it. Some are already calling for a "Cloud Computing Consortium", in the mould of the World Wide Web Consortium (W3C), to set standards that allow applications to migrate easily from one platform to another. One standard initiative, called "OpenSocial", already allows the same web-based application to run in several social networks, which are also clouds of sorts.

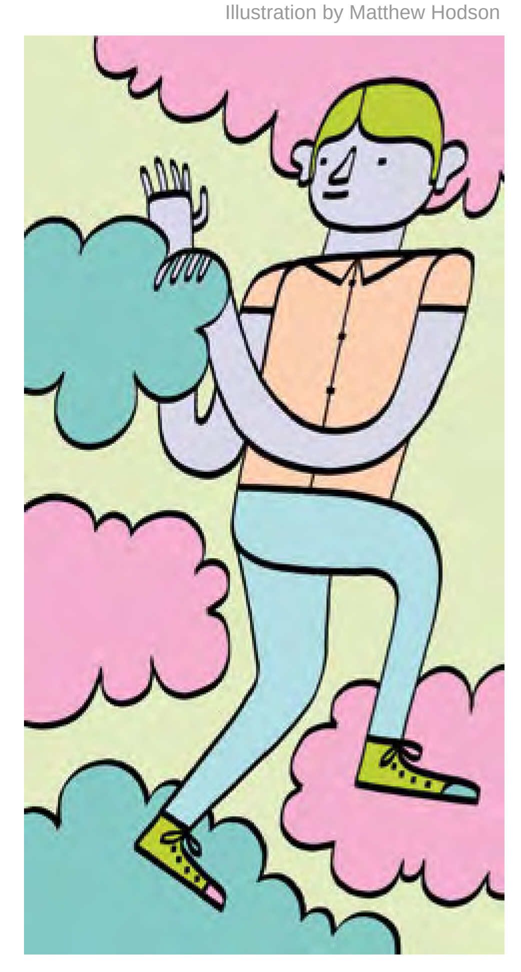
But standards go only so far. Some fear that one company could try to monopolise other key parts of the cloud; ironically, Microsoft worries that Google is doing exactly that with the online advertising market.

To Steve Ballmer, Microsoft's boss, Google's advertising platform is like a flywheel that picks up speed as more websites attract more advertisers, and vice versa.

Eric Schmidt, Google's chief executive, denies any evil intent to achieve world domination. He argues, with some justice, that it would be hard for Google to control the cloud, if only for technical reasons: much of it is already based on open standards, and its loose structure does not lend itself to locking customers in.

Mr Schmidt promises that Google will not lock its users in either. "Our competitive advantage is not from lock-in", he says, "but from having specialised knowledge of how to build data centres and how to build new software that is not reproducible, such as our search algorithm. This is how we make our money."

Illustration by Matthew Hodson



Yet Google is more like Microsoft than it likes to admit, says Nicholas Carr, a technology writer and blogger. Microsoft, he argues, achieved its dominant position in the PC world not least by commoditising products, such as the browser, that are complementary to its cash cows, such as Windows: as their cost came down, demand for Microsoft's products went up.

Similarly, Google's natural instinct is to do its utmost to encourage people to spend more time online, because that will give the company more opportunities to sell advertisements and collect data about them. According to Mr Carr, almost everything the company does—building huge data centres, fighting copyright restrictions, digitising the world's libraries, developing a new browser and, most recently, even helping to launch satellites—is aimed at increasing the use of the internet. "Google wants information to be free", he recently wrote in his blog, "because as the cost of information falls it makes more money."

But Google may never become as powerful as Microsoft because regulators are unlikely to let it. Microsoft was eventually put in the dock for abusing its monopoly because it got too greedy, pushing most of the rest of the industry to complain. Given that the world has already lived through the Microsoft drama and that Google will affect many more industries, the search company is likely to be restrained much earlier. The firm is currently in negotiations with the US Justice Department about a controversial advertising partnership between itself and one of its competitors, Yahoo!, which would further strengthen Google's position in online advertising.

Even if the economics of the cloud are still in flux, though, it is already clear that it will have far-reaching implications for businesses and for society as a whole.

The long nimbus

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From The Economist print edition

The cloud will make businesses more adaptable, interconnected and specialised—and often smaller

Illustration by Matthew Hodson



“BUSINESSES, as well as most organisations outside the business world, begin to shift from hierarchical processes to networked ones. Nearly every facet of human activity is transformed in some way by the emergent fabric of interconnection. This reorganisation leads to dramatic improvements in efficiency and productivity.” So said *Wired* magazine, the central organ of Web 1.0, in July 1997 in an essay entitled “The Long Boom”, arguing that the world was in for “25 years of prosperity, freedom and a better environment”. Back then, the article reflected the general optimism that led up to the internet bubble. Now, after two busts, several wars and growing fears of global warming, it makes for somewhat surreal reading.

The cloud lends itself to similar hyperbole. Yet so far there has not been much debate about its economic fallout—probably because the “new economy” ended badly and the newest one is currently doing even worse. There will be many ways in which the cloud will change businesses and the economy, most of them hard to predict, but one theme is already emerging. Businesses are becoming more like the technology itself: more adaptable, more interwoven and more specialised. These developments may not be new, but cloud computing will speed them up.

Corporate IT has always promised to make companies more agile. In the 1990s many companies re-engineered their business processes when they started using a form of software called enterprise-resource planning (ERP), which does things such as managing a firm’s finances and employees. But once these massive software packages were in place, it was exceedingly difficult to change them. Implementing SAP, the market leader in ERP, is like pouring concrete into your company, goes an old joke among IT types.

This helps to explain why in many firms IT departments and business units have traditionally been at loggerheads. In recent years tensions have worsened. Companies must grapple with ever-changing markets and regulations, yet IT budgets are being cut. Many firms now have a huge backlog of IT projects.

Hence the interest in cloud computing. It turns capital expenditure into operational expenditure, which makes things much easier and cheaper. Instead of having to shell out a lot of money for, say, a server to test an application and, even with luck, wait a few weeks for it to be up and running, managers just have to whip out a credit card, open an account at Amazon Web Services (AWS) and fire up a virtual machine for a few dollars.

In many firms senior managers probably do not even know that business units are using AWS or similar services. In some organisations, however, it has already become a much-appreciated R&D tool. Pharmaceutical companies, for instance, are regularly tapping into AWS to calculate simulations. Sogeti, a European consultancy, has used a cloud built by IBM to allow it to test new ideas and quickly put together an IT system for a company-wide brainstorming event.

Cloud services have also been hugely successful with start-ups, which can now enjoy infrastructure of the same quality as large companies. In fact, AWS is probably the main reason why there are now so many firms offering all kinds of “Web 2.0” services. Their usefulness may sometimes be hard to gauge, but that is a good thing. It is a sign of lively “combinatorial innovation”, made possible because entrepreneurs can cheaply try new combinations of technology, says Google’s Mr Varian.

Many start-ups would probably not even exist without the cloud. Take Animoto, a service that lets users turn photos into artsy music videos using artificial intelligence. When it launched on Facebook, a social network, demand was such that it had to increase the number of its virtual machines on AWS from 50 to 3,500 within three days. “You could give me unlimited funding,” says Adam Selipsky of AWS, “and I wouldn’t know how to deploy that many servers in 72 hours.”

Combinatorial innovation should also be made easier by the fact that the cloud will be a huge collection of electronic services based on standards. But this service-oriented architecture will be even more important for existing firms because it should free their inner workings—their “business processes”—from the straitjacket of their ERP systems and allow these processes to be more easily adapted, for instance to launch a new product.

Again, the software industry has been promising this for some years under the banner of service-oriented architecture. Yet the adoption of SOA has been slow and many projects have failed, says Chris Howard of the Burton Group, a consultancy. The reasons are not just technical but cultural; for example, some business units are not used to sharing data. Cloud computing will help resolve some of these problems. Many web-based services are built to be integrated into existing business processes.

Don’t do it yourself

What effect will all this have on the nature of the firm? If IT systems really allow companies to become more modular and flexible, this should foster further specialisation. It will become even easier to outsource business processes, or at least those parts of them where firms do not enjoy a competitive advantage. Companies will increasingly focus on their “core” and shed the “context”, in the words of Geoffrey Moore, managing director of TCG Advisors, a consultancy.

This also means that companies will rely more on services provided by others. They will increasingly form “process networks”, a term for loosely connected groupings of specialised firms coined by John Hagel, a business strategist at Deloitte & Touche, an auditing firm. His prime example is Li & Fung, a company based in Hong Kong that has assembled a global process network of nearly 10,000 business partners in the clothing industry from which it puts together customised supply chains for clothes designers.

Both trends could mean that in future huge clouds—which might be called “industry operating systems”—will provide basic services for a particular sector, for instance finance or logistics. On top of these systems will sit many specialised and interconnected firms, just like applications on a computing platform. Yet this is only half the story. The cloud changes not only the plumbing and structure of firms and industries, known as the “transactional layer”, but also their “interactional layer”, a term coined by Andy Mulholland, chief technologist of Capgemini, a consultancy. He defines this as the environment where all the interactions between people take place, both within an organisation and with its business partners.

Despite all the technology that has entered the workplace in recent years, so far this layer has not really changed. PCs certainly made people more productive, but most of their programs were not designed for collaboration. The enterprise applications they worked with were still centralised systems. And e-mail has in some ways made things worse as the flood of messages takes up lots of time and attention.

The dominant model is still that people first labour individually and then merge their respective efforts, says Mr Mulholland. “It’s not much different from the age of paper,” he writes in his book “Mesh Collaboration”. “Collaboration often means pulling up your chair next to your colleague so you can look at the same screen.”

Consumers have pulled ahead of companies in using cloud-based services that allow for better collaboration, such as blogs, wikis and social networks. The first generation of people that has grown up using all these tools is now entering the workforce. Being used to a culture of sharing information freely, these "digital natives" will be impatient with the rules of traditional corporate IT.

So it is helpful that firms have at last begun to embrace Web 2.0 technologies in earnest, a trend predictably called Enterprise 2.0. By 2013 companies around the globe will spend $4.6 billion on such tools, according to Forrester Research. What nobody knows is how firms will trade off the advantages of letting employees collaborate with the outside world against the associated risks, for instance that confidential information is leaked. Because of such security concerns (see chart 8), many firms block access to such sites as Facebook on company computers.



Companies may not have much choice but to open up, says Mr Mulholland. Employees will increasingly resist constraints on their use of technology, and they will have a growing need to reach beyond the corporate firewall. Twenty years ago, he argues, 80% of the knowledge that workers required to do their jobs resided within their company. Now it is only 20% because the world is changing ever faster. "We need to be open to new and unknown connections with people and content," he says.

Exploiting the "mesh", in the words of Mr Mulholland, will also mean that employees may build simple applications of their own that allow them quickly to automate repeat tasks, using internal and external IT services. A new product by Serena Software called Mashup Composer gives a foretaste of things to come. Using a visual interface, even the not so technically minded can quickly put together a service to deal, say, with travel requests or approve documents.

Yet the impact of the cloud will also be felt on a macroeconomic level. Just as it makes small firms more competitive, it will help developing economies to move ahead. "The biggest promise is that it will make computing cheaper and easier to use—and thus allow it to penetrate new markets," says Russ Daniels, chief technology officer for HP's cloud-services strategy.

Hop, skip and jump

The mobile phone has already enabled developing countries to skip fixed-line networks. Cloud computing could prove to be a similar "leapfrog" technology because it dispenses with the need to build a cumbersome IT infrastructure. "Software developers from a developing country can build just as great an application on our platform as somebody who lives in Palo Alto," says Mr Benioff of Salesforce.

Indeed, countries such as India will certainly take a big chunk of the global market for cloud services. Zoho, a popular suite of web-based applications, is operated by an Indian company, AdventNet. Indian hospitals are already offering specialised health-care services this way. The insurance arm of ICICI, an Indian bank, has used the technology to come up with innovative services such as a personalised insurance for diabetes. Premiums are adjusted depending on how well policyholders stick to a fitness plan. All this suggests that the economic impact of the cloud may be felt not only in the IT industry itself but in other sectors too. The internet disrupted the music business; Google disrupted the media; cloud-based companies could become disrupters in other inefficient industries. Buzzwords such as "Health Care 2.0", "Banking 2.0" or even "Education 2.0" could soon acquire real meaning.

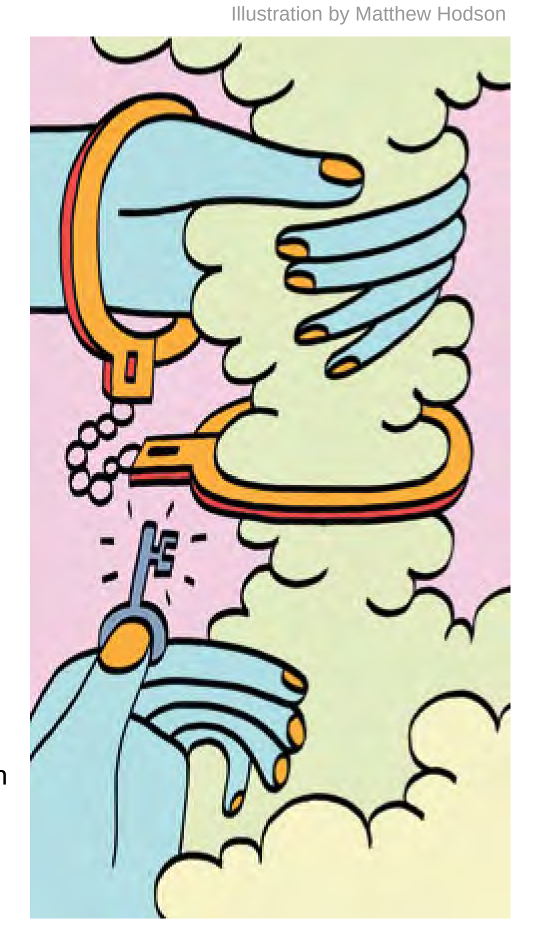
But given that the cloud is global by nature, how might it be regulated? The conclusion of this special report will offer some answers.

Computers without borders

Oct 23rd 2008
From The Economist print edition

The cloud may be the ultimate form of globalisation

Illustration by Matthew Hodson



READERS may be excused if they have never heard of Kinakuta. It is a tiny island dreamed up by Neal Stephenson in his novel “Cryptonomicon”. In the science-fiction classic, libertarian technologists and entrepreneurs try to turn it into a data haven for such things as anonymous online banking and electronic money.

Reality has indeed caught up with fantasy. Iceland is about to become a Kinakuta of sorts. Data Islandia, a local company, is trying to establish the island as a vault for a growing pile of data that firms must retain in order to comply with all kinds of regulations. It has a compelling pitch. With its cool climate, abundant geothermal energy and secure remoteness, Iceland appears to be a prime location for data archives.

As often, however, truth is stranger than fiction. In a way, Data Islandia is erecting borders in the cloud: it intends to store European data according to European regulation and American bits according to American rules. What is more, to keep the data safe during transport, they are picked up with a “data scooter” (in essence a container filled with disk drives) and taken to Iceland by aeroplane—as though fibre-optic links had never been invented.

This illustrates the political tensions that will arise with the cloud. In one way it is the ultimate form of globalisation: vast virtualised computer systems and electronic services know no borders. Yet governments are likely to go to great lengths to avoid losing even more control.

When the internet went mainstream in the late 1990s, libertarian thinkers argued that cyberspace was a distinct place calling for laws and legal institutions of its own. After all, they said, it was built in such a way “that it interprets censorship as damage and routes around it”. But many governments quickly found ways to block content they deemed offensive. Just look at China and its “great firewall”.

Controlling where data are stored and how they are treated is harder, though, because information can float freely in the cloud. And it is not just undemocratic governments that want to control their citizens' and companies' data: indeed there are nearly as many sets of data regulation as there are countries. “If we wanted to be on the safe side in terms of regulation, we probably would need 95 individual data centres,” says Chuck Hollis, a technologist at EMC, the leading maker of storage gear, which owns Mozy, a cloud service that allows users to back up their data.

There are technological fixes to this problem, too. Customers of Amazon's storage service, for instance, can have their data kept either in an American or a European data centre. In future, cloud providers will offer many more options for where data are kept and how they are protected. It seems possible that data as well as content will eventually travel with security, location and expiry policies attached.

It is when computers become virtual machines that things get really tricky. These days IT systems are at the core of many companies—and just like data, these systems can now live in a variety of places. What happens if they start to migrate to another country where power is cheaper or regulation laxer? Similarly, if services are a combination of elements provided in different jurisdictions, who is liable if something goes wrong?

The cloud's potential political and social effect is only now entering the public debate. IT firms are putting

it on the agenda on both sides of the Atlantic. In mid-September, for instance, Google organised a discussion on the subject in Washington, DC. A few days later SAP presented a white paper in Brussels pointing out that policymakers are not aware of the dramatic economic impact of the “Future Internet”, as the paper calls the cloud.

IT industry leaders note that officials from many countries have begun to take an interest in the cloud. Some just want data centres to be built in their country to create jobs; others are concerned about issues of law enforcement and jurisdiction. The danger, they say, is that cloud providers might be obliged to build more data centres than are needed and have to comply with many different regulatory regimes. Some of them have been floating the idea of “free-trade zones” for data centres where common rules would apply.

Yet such ideas appear at odds with another big question that could keep the cloud from growing: how to protect privacy. “Consumers expect their information will be treated the same way on the cloud as if it were stored at home on their own computers,” says Ari Schwartz of the Centre for Democracy and Technology, an advocacy group. Many of the devices that feed into it, such as sensors and cameras, will be intrusive. For example, Google’s vans go round taking street-by-street pictures of cities for the company’s online map service called “Street View”. The pictures are meant to help people find their way around, but also often show passers-by in embarrassing situations. To protect their identity, Google now blurs their faces and licence plates.

Hands off my data

But it is not only personal information that could get out into the open. Privacy is a worry for companies too—and not just because criminals or spies might intercept their data. Once they are in the cloud, governments can also get their hands on them more easily. SWIFT, the organisation that manages international bank transfers, is planning to build a data centre in neutral Switzerland. That will allow it to keep data about European transfers on the old continent, where it cannot be subpoenaed by the American government. Web-based e-mail is not safe either. Thanks to the Stored Communications Act, American law enforcers can read people’s messages—and do not even have to tell the recipient.

Just as too much regulation may keep the cloud from rising high, so could lack of privacy. If consumers and companies cannot be sure that their information is safe, they will err on the side of caution. But despite all the caveats, the precipitation from the cloud will be huge.

Sources and acknowledgments

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Technology start-ups face the downturn

Fright night in the valley

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Having learnt from the dotcom bust, technology entrepreneurs hope to stay afloat this time around

Alamy



HALLOWEEN is still a week away, but homes throughout Silicon Valley are already adorned with images of witches, skeletons and assorted ghouls and gargoyles. Horror stories have also been plentiful in the Valley, courtesy of the region's high-tech companies. On October 21st Yahoo! said it would cut its staff of around 15,000 by at least a tenth. Given the internet firm's woes—its third-quarter profit fell by 64%, to $54m, as online advertising withered—the cuts were perhaps inevitable. Equally striking has been a wave of lay-offs at much smaller start-up companies, which are bracing themselves for a coming recession.

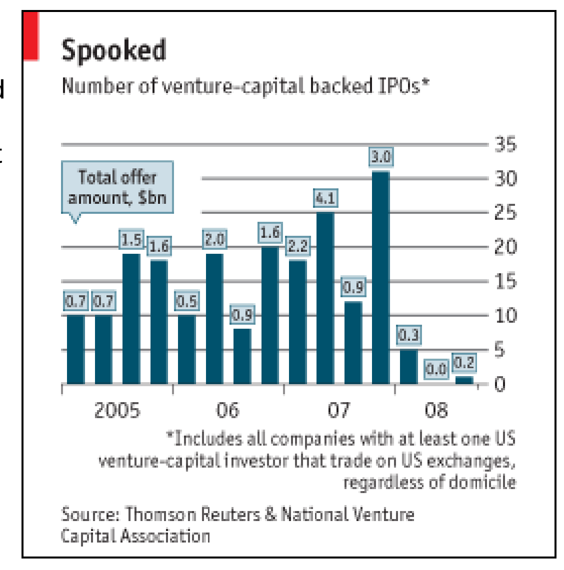
Unlike firms in most other industries, which have not seen a severe downturn since the early 1990s, tech companies still bear the scars of the dotcom bust of 2001. The folk that ran them then learnt painful lessons that many of today's entrepreneurs appear to have taken on board—and that managers in other companies would do well to reflect on. Chief among them are the importance of swift and deep cost-cutting; of focusing scarce resources on core activities; and of convincing investors that your business strategy is a winner.

Given that entrepreneurs tend to be tireless optimists, even experienced hands need a scare. And they are getting it from the venture-capital outfits that have backed many fledgling firms. Sequoia Capital, a leading investor in start-ups, began a recent presentation to bosses of companies in which it owns a stake with a Halloween-style image of a gravestone carrying the words "R.I.P. Good Times". Sequoia went on to urge the executives to cut costs fast so that their firms would not run out of money before becoming profitable. Other venture capitalists are echoing its message. "Rule number one is to take immediate measures so you can stay in the game," says Mike Speiser of Sutter Hill Ventures, another VC firm.

Life will be hardest for the many start-ups that are still in the red. Those that need more capital soon will get it only at a very high price if they can get it at all, as venture capitalists tighten their purse strings. According to the National Venture Capital Association, a trade group, and PricewaterhouseCoopers, a consultancy, VC firms provided $7.1 billion of funding in the third quarter of this year, but are likely to cut that amount in coming months.

Venture capitalists are feeling the pinch too. They are finding it harder to unload the stakes they own in start-ups. Big companies which are themselves short of cash are extremely wary of splashing out on the minnows in VC firms' portfolios. At the same time, investors are shunning initial public offerings of venture-backed firms (see chart), which have fallen to their lowest level since 1977. Experts reckon that the market may

remain comatose until at least the end of next year.



All this explains why the bosses of several start-ups have started to wield a big axe. Redfin, an online property-broker, and AdBrite, a web-based advertising network, which both had about 100 employees, have slashed their headcount by 20% and 40% respectively this month. Pandora, a music-streaming business, and Searchme, a visual search engine, are among the rapidly growing collection of other start-ups that have also announced job losses. Deep cuts like these may be painful in the short-term, but they are better both for profits and morale than repeated rounds of small lay-offs. In 2001 many firms trimmed too little, too late.

Of course, slashing the workforce now may not make sense for some start-ups. Those focused on areas such as gaming and health care, which may be less vulnerable to a recession, are likely to keep hiring. And companies making big lay-offs could still add new heads in some areas. Announcing a 25% cut in staff numbers at Zillow, another property-related website, Rich Barton, the company's chief executive, said in a blog posting that the firm would still hire people in ad sales and other revenue-generating roles.

Another useful strategy is to shed projects that are not central to a start-up's business. Executives at Jive Software, which produces online collaboration tools for corporate clients, say it is now far better at scrapping initiatives that do not seem to be paying off. Once these have been placed on a “kill list”, there is no further discussion about them. In the past the lack of a formal process for canning ideas meant that many lived on, absorbing time and resources better spent elsewhere.

Elon Musk, boss of Tesla Motors, a start-up that recently began producing an electric sports car, learnt useful lessons from the dotcom bust. He steered PayPal through the early days of the shakeout by maintaining a focus on its core online-payments business and by ditching plans to develop other offerings. Thanks to this discipline, PayPal continued to grow and sold itself to eBay in July 2002. At Tesla Motors, he has delayed plans to add an electric sedan to its product-range from 2010 to mid-2011 so that the company can concentrate more resources on improving margins on its existing car and on expanding its profitable business of building powertrains for other carmakers—a decision partly inspired by his experience at PayPal.

Mr Musk is also trimming jobs at Tesla. “You need to show investors that you have been super-frugal with their money,” he says. More than ever, entrepreneurs need to be able to reassure VC firms on the basic principle that their business models can in future throw off far more cash than investors have pumped into their firms. Mike Kwatinetz of Azure Capital Partners, a VC firm, reckons that many of what he calls “carpetbagger entrepreneurs”—inexperienced youngsters who turned up in Silicon Valley in recent years with a view to getting rich quick—will come a cropper in the downturn because they do not have the foggiest idea of how to turn a profit.

Yet Mr Kwatinetz is bullish about the prospects for those start-ups that manage to survive the crisis. They will face a much less crowded field and their managers will have honed their moneymaking skills in the harshest of all environments. He is on the lookout for firms that could become the next Bill Me Later, which Azure Capital bought into in 2001. Founded the previous year, the company lets internet users make online purchases without using a credit card. After surviving several ups and downs, it was sold to eBay on October 6th for some $945m. It is such Croesus-like sums that make start-ups worth all the toil and trouble.

Kirk Kerkorian

No country for old men

Oct 23rd 2008 | NEW YORK
From The Economist print edition

Kirk Kerkorian is unexpectedly selling out of Ford

THIS is proving a ghastly year for Kirk Kerkorian, a 91-year-old billionaire who began 2008 as the world's 41st richest person. He reportedly told friends recently that he had "lived one year too long", after the value of his stake in MGM Mirage, which owns casinos and about half the rooms on the Las Vegas Strip, plunged from $14 billion to $2 billion. This week he took another hit as he started to sell his 6.4% stake in Ford at a price which looks likely to create a loss of at least $700m.

Mr Kerkorian bought the shares through his investment firm, Tracinda, early this summer for about $1 billion. He had been encouraged by unexpectedly good first-quarter figures from the carmaker and had taken a liking to Alan Mulally, Ford's newish boss. Taking the stake was in keeping with his long-term interest in shaking up Detroit's Big Three carmakers. Mr Kerkorian once held nearly 10% of General Motors' shares and was a perpetual thorn in its management's side. In 2006 he unsuccessfully tried to shove the firm into the arms of Carlos Ghosn's Renault-Nissan alliance.

Tracinda says that it was selling its stake in Ford because it sees better value in gaming and the oil and gas industries. Maybe, but the timing is odd. Although things have only got worse for America's car industry since Mr Kerkorian began his flirtation with Ford, the situation is still fluid. Congress has just voted Detroit a $25 billion loan bail-out and GM is in talks with Cerberus Capital to take over Chrysler, the feeblest of the big three. If that deal goes ahead, GM would want to take most of Chrysler's capacity out of the market, meaning that Ford would enjoy what amounts to a free ride. Ford is also not desperately short of cash, unlike GM, and it has a coherent strategy based on bringing its excellent European products to America. Mr Kerkorian is not the only person to abandon Ford, however: its chief financial officer left this month, as did a prominent board member, Sir John Bond, the former boss of HSBC.

Meanwhile, another aged billionaire, the octogenarian and media tycoon, Sumner Redstone, may be in even worse shape than Mr Kerkorian. Shares in the two media firms he controls, CBS and Viacom, recently fell to historic lows. On October 13th, Mr Redstone's indebted holding company, National Amusements, was suddenly forced to sell a chunk of shares worth $233m in the two firms, in order to avoid breaching its loan covenants.

Spare a thought, too, for a third Wall Street legend, Hank Greenberg, 83, who recently saw big stakes in American International Group and Lehman Brothers wiped out within a couple of days. But it is not all bad for America's business gerontocracy. Warren Buffett, a sprightly 78, seems back on form, having recently bought big stakes in General Electric, Goldman Sachs and Constellation. And Paul Volcker, 81, is being touted as a potential Treasury secretary. Age shall not weary them all.

Pharmaceuticals

A chill wind

Oct 23rd 2008
From The Economist print edition

Iceland's promising drugs firms are in trouble



Winding round the gene pool

IT MAY seem surprising, but tiny Iceland has produced two of the world's most innovative small drugs companies. By combining advanced gene-sequencing technologies with privileged access to the genetic data of Icelanders, DeCode Genetics pioneered the field of personal genomics. And Actavis, its compatriot, has grown from obscurity a few years ago through clever acquisitions and global investments into the world's fifth-largest generic drugs maker.

In normal times, these firms would be the toast of the town in Reykjavik. Iceland is an ideal place to study the link between genetic variations and diseases, as its population is ethnically homogenous and immigration has been limited. Alas, these are hardly normal times for the country, which is in the grip of a spectacular financial meltdown. DeCode, once a darling of technology investors, now faces the embarrassing prospect of getting kicked out of the NASDAQ stock exchange in America. It could be ousted next week if its market value does not climb back above $50m. Rumours are swirling that Actavis, which is controlled by an Icelandic investment group called Novator, may soon be put up for sale.

What happened? Part of the answer is that these promising firms have been hit by the financial crisis, through no fault of their own. DeCode has produced a string of recent scientific advances that reconfirm its status as a global leader in its field. In just the past few weeks, the firm's researchers have unveiled several genetic mutations linked to schizophrenia, made advances on a drug targeting Alzheimer's disease and fingered genes linked to basal cell carcinoma. DeCode has tried to defend itself against the credit crunch. Feeling the pain from the initial credit squeeze last year and fearing worse to come, the firm cut its workforce by 30% this year and reduced its cash burn rate by half.

Despite these steps, the firm's access to credit has virtually dried up over the past few weeks. For a small biotech firm without blockbuster revenues, that has dealt a severe blow. Worse is the fact that some $30m of its money was allegedly mismanaged by Lehman Brothers, an investment bank which went bankrupt in September. Kari Stefansson, the firm's founder, points to the ill-judged investment of his firm's funds in risky American auction-rate securities. The market for these has seized up, adding to the firm's cash squeeze.

Actavis, too, has been a victim of circumstance. The firm diversified rapidly over the past few years and built a global platform from which to sell its products. That has helped it weather the Icelandic collapse—the local market contributes barely 1% of its sales. Sigurdur Olafsson, the firm's chief executive, also points out that because his firm is privately held, it has not been directly affected by stockmarket declines.

Alas, the same cannot be said for the firm's owner. Thor Bjorgolfsson, a local billionaire, controls the generics firm through Novator. This investment vehicle had no direct investments in Icelandic banks—but Mr Bjorgolfsson does. He and his father had a big stake in Landsbanki, which was nationalised earlier this month. Because he lost a large slice of his fortune when that happened, some think that he may decide to sell off Actavis in order to raise cash.

Despite today's gloom, there may yet be a silver lining. Since these firms are strong in their field, they should be able to find new owners or partners with deep pockets, be they big pharma firms or private-equity investors. They could thus emerge stronger from the crisis. Mr Stefansson is crafting a new strategy for a "smaller, leaner" DeCode that, if properly financed, could one day grow into a biotech giant like Genentech. As for Actavis, Mr Olafsson says his firm's sales are not affected so far. He even expects the recession to boost sales, as governments look to generics to help control health-care costs. Perhaps that is a bit cheeky, but it was precisely such cheek that propelled these Icelandic firms to the world stage

in the first place.



American retailing

Left on the shelf

Oct 23rd 2008 | NEW YORK
From The Economist print edition

America's retailers need to respond to plummeting consumer demand

THE unthinkable has happened. American consumers are losing their urge to shop. Maybe it is because they have been scared into prudence, maybe it is because they can no longer get the credit to which they have long been addicted, but they are spending less. Every single retailer is hurting from the drop in demand, but the weakest are in grave trouble. Some, already struggling in an intensely competitive retailing market, are in free-fall, possibly even heading for bankruptcy. For their stronger competitors, that makes the present such an unmissable opportunity.

Which is why shares in Wal-Mart are worth more than at any time in 2006-07, even though they are down by almost a fifth from their high in September. Target, a struggling rival, by contrast, has seen its share price drop by nearly half since September to its lowest in four years. The stockmarket value of Sears, another famous name, is little more than one-quarter of what it was in April last year. Shares in Whole Foods Market, an upmarket organic food retailer nicknamed "whole paycheck market", are down by nearly 80% from their highest level, and at their lowest since 2001. Similarly, shares in Best Buy have tumbled, but the electronics retailer is in a bullish mood. It expects to expand its market share if a competitor, Circuit City, eventually goes bust.

"This bifurcation, in which the strong get stronger, the weak weaker, is occurring at every level of the retailing industry, from top to bottom," says Thierry Chassaing, a consultant at Boston Consulting Group (BCG). Among deep discounters, too, such as Dollar General and Dollar Tree, which have benefited from shoppers looking for the best possible value, the leaders are gaining at the expense of laggards. Even dollar stores are finding life harder, as customers are somehow finding their way to goods that yield their sellers the very lowest profit margins.

No retailer can afford to delay its response to this downturn in the hope that sales might somehow recover, argues an article by Ashish Kotecha, Josh Leibowitz and Ian McKenzie in the *McKinsey Quarterly*, published by the consultancy of the same name. This contains a study of the past two downturns in American retailing, in 1990-91 and 2000-01, which found that retail revenues were quick to fall and slow to recover, even once the economy started to pick up. Thus, the authors argue, "retailers should move quickly to minimise performance deterioration".

That may be easier said than done. Efficiency-enhancing restructuring was already needed in many cases. If retail bosses failed to make necessary changes before, analysts say, it remains to be seen whether they can implement them now.

A danger is to cut labour costs in a way that damages customer service. That could be fatal at a time when retailers need to fight for each sale. The best retailers understand this. Best Buy has found that its "geek squad", that helps customers in each of its stores work out how to use their new electronic appliances, has been a factor in its recent success. Best Buy is even taking it overseas to Britain, in a partnership with the Carphone Warehouse, a mobile-phone retailer. In a similar vein, well run foreign retailers such as Tesco and Aldi, a German hard discounter, may find their expansion in America goes better now that so many local rivals are feeling pain (the two firms are fighting a price war against each other at home in Europe).

Another conundrum is how far to cut prices to shift stock. According to Michael Silverstein, another BCG consultant and author of "Treasure Hunt: Inside the Mind of the New Consumer", consumers are intensifying their search for value, trading down, negotiating harder in every single product category. They are even asking themselves—horror of horrors—"Do I really need this?".

Some retailers are finding that deep price cutting may have a perverse effect, according to Mr Silverstein. Rather than see an opportunity to snap up a bargain, today's value-obsessed American shopper is "just as likely to push the pause button, thinking that if the shop is cutting prices this much now, I might get it

even cheaper in a few weeks when the economy gets really bad". In other words, wait while stocks last.

Fast food in China

Here comes a whopper

Oct 23rd 2008 | BEIJING
From The Economist print edition

The world's second-largest burger chain is gearing up in China

CHINA may boast a 5,000-year-old culinary tradition, but when it comes to fast food, Western-style outlets rule. For this you can thank—or blame—changing consumer tastes, and the breathless expansion plans of chain restaurants, which are eager to grab a bigger slice of the country's estimated annual 200 billion yuan ($29 billion) fast-food market.

For two decades the battle for the modern Chinese stomach was fought between two American giants: McDonald's, the world's largest fast-food chain; and Yum! Brands, which operates the KFC and Pizza Hut brands in China. Yum!, which first arrived in China in 1987 (three years before McDonald's), has always stayed ahead of its rival—going by both the number of restaurants and consumers' awareness of the brand. In 2005 the two titans were joined by another American stalwart, Burger King, the world's second-largest burger chain.

In April Burger King had just 12 outlets on the mainland, including nine in Shanghai. But after this cautious start, the company is pushing ahead with a faster store roll-out: in June it announced plans to open between 250 and 300 outlets in China over the next five years, including another ten restaurants in Shanghai. As in other markets, 90% of them will be franchised and a tenth owned by Burger King. For comparison, KFC has more than 2,200 outlets in some 450 cities and McDonald's has 950 outlets.

Airport eateries will also be vital. Some 200 of Burger King's 11,500 outlets worldwide are at airports. Catering there has a number of advantages, including steady, captive customers and limited competition. In February Burger King opened its first outlet at Beijing Capital Airport's Terminal 3, and the following month it opened two restaurants at Shanghai Pudong International Airport's Terminal 2. Another ten mainland airports are also on its menu.

One problem for Burger King is that its trademark "Whopper" is made out of beef. Like McDonald's, the chain must cope with the fact that Chinese consumers prefer chicken. McDonald's has launched lots of marketing campaigns to try and convince mainland customers about the health benefits of eating beef (apparently, there are some). This has done much to overcome the traditional indifference of Chinese towards beef, probably saving time and money for Burger King's own marketing campaigns.

Burgers with Chinese characteristics

Burger King is also adapting its menu for China. It has added chicken dishes and has also added chili to some of its offerings. It has not localised its China menu as much as its rivals have, however. KFC has gone the furthest in tailoring its menu for Chinese tastes, with offerings ranging from pumpkin porridge and Beijing chicken rolls to the Chinese deep-fried twisted dough sticks (*youtiao*) on its breakfast menu. McDonald's (and to a lesser extent, KFC) is also ahead of Burger King in making "off-the-menu" innovations. These include "dessert" kiosks selling just sweet pastries and drinks. McDonald's also runs a 24-hour service at 600 outlets.

With its two American rivals so far ahead, is Burger King likely to be successful in China? There should be demand enough for more than two big American fast-food firms here, analysts reckon, and the company has the resources to finance rapid and sustained expansion into mainland cities. Most important, it is strongly motivated. Burger King is keen to build its business outside America. Four-fifths of the new restaurants to open this year will be outside its home turf, and the company aims to double its Asia-Pacific presence to some 1,400 outlets over the next five years.

In China, Burger King's strategy is particularly to chase younger, more individualistic diners in the country's big cities. Its idea is that these restaurant-goers will want to set themselves apart from older family members or colleagues by trying the newcomer. If so, the Whopper—sold in China as *huangbao*, or

“Emperor Burger”—may yet dethrone the Big Mac here.

Face value

Climate of fear

Oct 23rd 2008
From The Economist print edition

Can Stavros Dimas successfully defend the environment against economic gloom?

Reuters



STAVROS DIMAS concedes that his appointment in 2004 as the European Union's environment commissioner was taken by some as a sign that Europe was going soft on tackling climate change. "All hope is lost," wailed the *Guardian*, a left-of-centre British newspaper. Margot Wallström, a gutsy Swedish social democrat who held the job before him, fitted the part in a way the 63-year-old Mr Dimas did not. He recalls: "People were sceptical about me because of my background. They saw me as an ageing conservative politician and former Wall Street lawyer from a country [Greece] with a poor environmental record." As greens despaired, business lobbyists breathed a sigh of relief.

But Mr Dimas has confounded the expectations of both sides. He has won praise from the likes of Greenpeace, Friends of the Earth and T&E (a sustainable-transport think tank) for fighting to preserve Europe's credentials as an environmental standard bearer. Now Mr Dimas faces his hardest task yet: defending Europe's hard-won commitments on the environment against politicians and companies fearful of looming recession.

Two policies painstakingly constructed by Mr Dimas over the past few years are in jeopardy. The first is proposed legislation to fine carmakers whose vehicles fail to meet an emissions target of 130g of CO_2 per km. This law is due to come into force across the European Union in 2012. The European car industry is using all of its considerable lobbying power to dilute the 130g/km rules, with particular pressure coming from Germany's carmakers. The car firms argue that, with demand and profits collapsing amid the credit crisis, this is hardly the moment to threaten them with stiff financial penalties.

The second is an ambitious, legally binding plan to cut Europe's overall carbon emissions by at least 20% from their 1990 levels by 2020, and to derive 20% of all Europe's energy needs from renewable sources. A coalition of eastern European countries, led by Poland and supported by Italy, has banded together to fight the so-called 20/20/20 plan. They worry that their economies will be clobbered because they still depend on coal-fired power stations for most of their electricity. They chorus that what seemed like a good idea in March 2007, when governments signed up to Mr Dimas' proposals, is no longer affordable.

Although Mr Dimas has another nine months in office (he is expected to leave Brussels when the commission completes its term in the middle of next year), he has in practice only until December to overcome the objections to his plans. That is when the French presidency comes to an end. The Czechs, who take over in January, are seen as being in the slow lane when it comes to environmental policy.

Despite his quiet manner, no one should doubt that Mr Dimas cares about climate change. He does not play the woolly green; rather, says a close colleague, he is someone for whom “arguments count”. The weight of scientific evidence about man-made climate change and the loss of biodiversity meant that he was already convinced about the need for action when he took the job. What he was less certain of was how to go about it.

Very early on, at the 2004 climate change convention in Buenos Aires, Mr Dimas realised that the opposition of the Bush administration had put paid to any progress on multilateral agreements. Speaking of the Americans, he says: “It was like talking to a wall. Even words like ‘future negotiations’ were prohibited.” That meant two things. The first was that discussions with countries such as China and Brazil would have to be bilateral. The second was that Europe had to be an exemplar to the rest of the world. “It was important that we were practising what we were preaching—that we would advance the case internationally at the same time as doing it internally,” he says.

His first task was to fix the European emissions-trading scheme and make it the core of Europe’s environmental policy. During the initial trading period, which ran from 2005 to 2007, the price of carbon emissions collapsed because the commission, pressed by national governments, had approved overgenerous national allocations. Any notion of a cap was almost completely undermined. With meticulous attention to detail, Mr Dimas set about drawing up and negotiating 25 new and much tougher national-allocation plans in preparation for the 2008-12 trading period. Governments all supported action on climate change, says Mr Dimas, “but when it came down to specifics, they all had reasons why individually they should be given special treatment. At times we felt very lonely, but we did it.”

Mr Dimas was quick to seize on the economic case in favour of timely action made by a review by Sir Nicholas Stern, a British economist. The growing awareness of not just the environmental, but also the economic consequences of climate change had made both politicians and voters more receptive to his call for action. Mr Dimas was also optimistic that they were starting to believe that, far from damaging the competitiveness of its economy, Europe stood to gain a first-mover advantage by leading the way to a low-carbon future.

Jobs versus the planet

That was then. Now the mood among Europe’s political and business elites is much more fearful and pessimistic: saving jobs has become a more urgent priority than saving the planet. Mr Dimas may need to be flexible. Under the original terms of the 20/20/20 pact, countries were expected to spend the receipts from auctioning permits on improving their energy efficiency. Last week, however, Mr Dimas suggested that they would be able to use the money however they wanted. More compromises between now and December are almost inevitable, and environmental groups are already preparing their brickbats. But Mr Dimas remains convinced that the overall “architecture” and targets of the 20/20/20 plan will survive.

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Hedge funds in trouble

The incredible shrinking funds

Oct 23rd 2008
From The Economist print edition

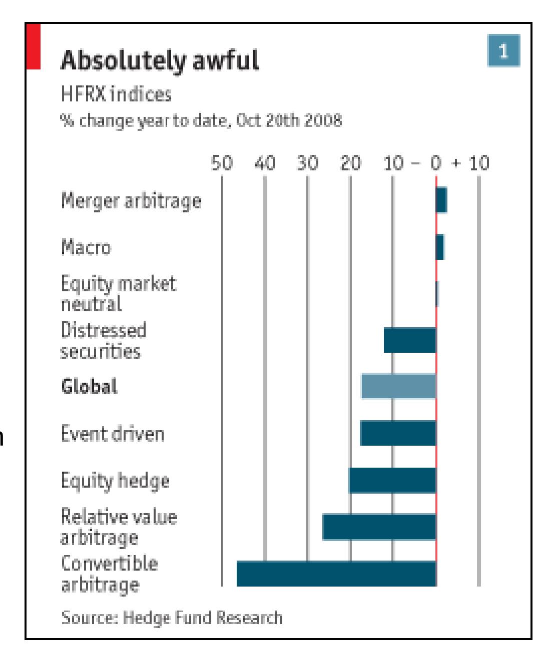
High borrowing and the credit crisis are bad enough for hedge funds. Panicky clients are worse



ON THE trading floor of one of London's big hedge funds, the banks of Bloomberg screens still flicker with life but the traders are almost silent. "None of us can quite believe what we are seeing," says a senior manager. A year ago hedge funds were the omnipotent vanguard of financial capitalism. They were uncompromising in their search for returns, and they dominated trading activity in most securities. But the industry has been humbled.

The typical fund has fallen by almost a fifth so far this year, according to Hedge Fund Research (HFR), an analysis firm (see chart 1). "Convertible arbitrage" funds—which try to exploit price anomalies among corporate bonds—have lost a staggering 46%. By some margin 2008 has been hedge funds' worst year since HFR began compiling records in 1990.

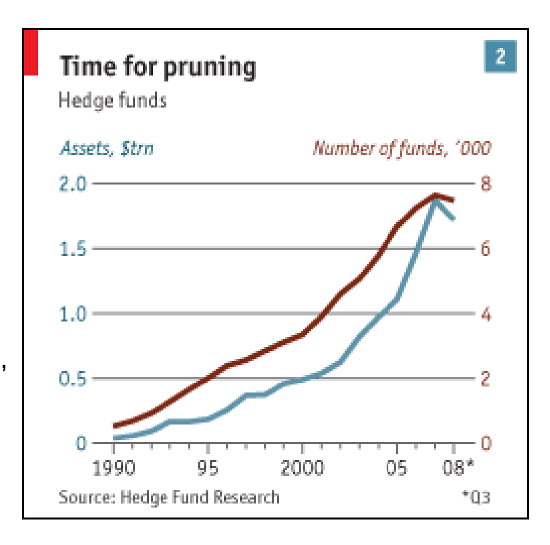
The carnage is indiscriminate. In Asia as well as London and America, hedge funds are closing some or even all of their operations. Few strategies have worked well. Ken Griffin, the boss of Citadel, a fund based in Chicago and known for its quantitative trading techniques, told investors that September was "the single worst month, by far" in its history. Even David Einhorn, an American short-seller who bet successfully on Lehman Brothers' demise, has lost plenty.



Over the next few quarters the fallout is likely to be brutal. Between 1990 and last year the industry's assets under management grew almost 50-fold, to nearly $2 trillion (see chart 2). Now industry executives predict that assets could fall by 30-40%, as clients stampede for the exit. The number of funds, which climbed to over 7,000 as a generation of financiers headed for the gold-paved streets of Mayfair in London and Greenwich, Connecticut, could fall by half.

It wasn't supposed to be like this. After all, most

hedge funds pride themselves on providing clients with positive "absolute returns"—ie, on turning a profit whatever the financial weather. Until now that promise had been largely met. In 1998, the year that Long-Term Capital Management (LTCM), a giant hedge fund, collapsed, the industry still managed a small positive return. During the previous big financial bust of 2001 and 2002, when American shares fell by over one-third, the average hedge fund was roughly flat.



This time, however, it really is different. Bans on short-selling have made many strategies unworkable. Poor management by hedge funds may be partly to blame: the industry has more than its fair share of illiquid assets that have been hammered during the crisis. But it also appears that forced sales of assets by hedge funds have driven prices lower, in turn hurting performance—a typical case of contagion. The 30 core American equity holdings of the biggest hedge funds, tracked by analysts at Merrill Lynch, have underperformed the stockmarket since the end of August.

What is the cause of the fire sales that seem to be at the root of the industry's problems? The obvious answer is a withdrawal of credit, which has in turn forced hedge funds to offload assets. Sceptics have long argued that for all the skill they claim to possess, hedge funds just use cheap money to amplify mediocre returns. By this account they are simply another part of a vast, debt-dependent ecosystem that is now being starved of oxygen. Yet the role leverage has played in bringing the industry to its knees is subtler than this. And there is another prime suspect for hedge funds' suffering: their own clients.

Sweeping generalisations about the degree of leverage among hedge funds are misleading, because funds come in many different types. The term "hedged fund" was coined by Alfred Winslow Jones, who in 1949 launched a vehicle that simultaneously bought and sold short shares, thus reducing sensitivity to overall movements in the market. Since then many varieties have sprung up, from the global macro funds most fashionable in the 1980s and 1990s, which bet on the fortunes of countries and currencies, to funds which try to exploit tiny differences in the prices of bonds and derivatives.

Leverage: the long and the short of it

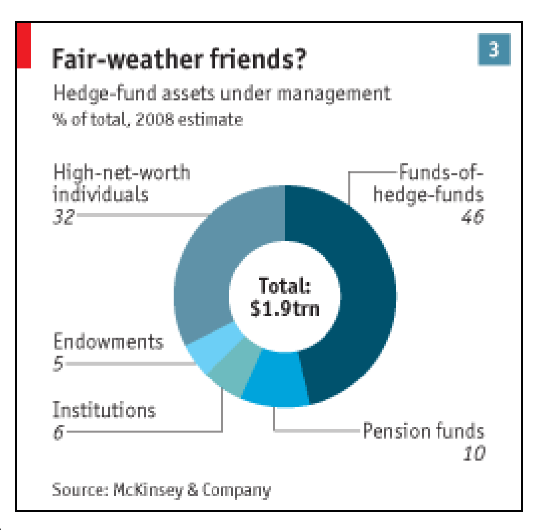
Hedge funds today do have some things in common: performance-related fees; light regulation; client lists replete with institutions and rich individuals; and a symbiotic relationship with prime brokers at investment banks, who provide them with credit, execute trades and help administer their funds (see article). But high leverage is not the unifying factor many believe it to be.

According to one prime broker's estimate, the industry as a whole has a ratio of assets to equity of about 1.3, against 1.8 a year ago. The assets themselves often contain further embedded leverage, through, for example, derivatives. A study by McKinsey, a consultancy, suggests that this might take the industry's leverage today to two or three times equity. By the supercharged standards of contemporary finance, that is not high: most investment banks have been running with ratios of more than 20. Regulators used to worry about the danger hedge funds might pose to their prime brokers. After the failures of Bear Stearns and Lehman Brothers the risk turned out to be the other way round.

The industry's aggregate leverage has undoubtedly caused it trouble. As asset prices have fallen, margin calls have increased, and these may have been met by selling assets. But there does not appear to have been a systematic withdrawal of bank credit from hedge funds. Most prime brokers say they have not tightened lending terms overall. They have got tougher with funds using higher leverage of, say, over five times, to pursue arbitrage strategies, in convertible bonds for example. This selective withdrawal of credit helps explain why such funds have done so badly. But because these funds account for less than a quarter of total assets, it cannot explain the woe of the industry overall.

A fuller explanation must include the increasingly jittery nature of hedge funds' clients. As the industry has grown, its customer base has widened beyond the original core of very wealthy and (reputedly) loyal individuals. Institutions have put money into hedge funds in the hope of improving risk-adjusted returns. And funds-of-hedge-funds, which act as intermediaries for private banks, some institutions and individuals who are merely affluent, have become hugely important. They supply more than 40% of industry assets under management, compared with only 5% in 1990 (see chart 3).

Even if institutions want to buy and hold their positions, some are being forced to raise cash. One hedge-fund manager says that pension funds have onerous commitments to private equity, which they are meeting by selling out of hedge funds. And there is a widespread feeling that money originated through funds-of-hedge-funds is liable to get jumpy at any hint of trouble and skedaddle if losses are made. One fund-of-funds manager says he rushes to be the first out if he suspects that others may desert a hedge fund. Some also argue that the behaviour of the individuals who invest through funds-of-funds most closely resembles that of mutual-fund investors, traditionally viewed as finance's headless chickens.



Despite the fidgetiness of their new clients, few hedge funds have locked in their money for long periods. Most funds allow redemptions each quarter: only those with the strongest records, such as TCI, an activist firm in London, can lock money in for several years. Funds-of-hedge-funds have marketed themselves as providing monthly liquidity, a claim that holds true only if clients don't all test it at once. The result is eerily similar to the plight of those banks that relied too much on fickle wholesale funding. If investors ask for their money back, funds often have to sell out of illiquid positions to raise cash, which may force prices down. In September clients withdrew a record $40 billion from hedge funds, according to analysis by TrimTabs, a research firm.

Fear of redemptions is just as damaging as the fact of them: if managers worry that clients will bail out, they may try to raise cash in anticipation. Merrill Lynch estimates that between July and August alone, the industry's cash holdings rose from $156 billion to a record $184 billion, equivalent to 11% of assets under management. Since then the vicious cycle of forced sales to fund anticipated or actual redemptions has only intensified.



Survival of the biggest

Admittedly, hedge funds have been through difficult times before. The last full year of net redemptions in recent memory was 1994, when 1% of clients' money was pulled out of hedge funds. By the following year the industry was growing again. But last month alone 2% of money was withdrawn. And the omens from the last real bear market for hedge funds, 40 years ago, are far less encouraging. Between the end of 1968 and September 1970, the assets of America's top 28 hedge funds dropped by two-thirds, according to Sebastian Mallaby, an author (and a former *Economist* journalist). Eventually luminaries such as George Soros and Michael Steinhardt emerged from the ruins, but for the industry it was a long, hard

slog.

That is exactly what is in prospect again. Unless performance recovers sharply and soon, clients will continue to walk away. And even if returns do pick up, it will be a while before managers make much money, because most funds have “high-water mark” structures. These demand that big losses be recovered before performance fees can be charged again. That will be hardest for smaller funds, which have higher fixed costs relative to their assets, and which some clients already worry have poor risk controls. Firms with less than $500m under management account for about three-quarters of the world’s 7,000-odd hedge funds, although they manage less than a tenth of the industry’s assets. The outlook for start-ups without records is particularly bleak.

The death of many of the industry’s tiddlers will compound a trend that started in 2006, of clients consolidating their hedge-fund holdings with a few big managers. Those firms are working hard to strip down their cost bases by shedding employees and minimising the risk of trading blow-ups over the next year. Their main ambition for the time being is to be still standing when the dust settles.

What kind of world the survivors will face depends to some extent on politics and regulation. As lightly regulated private entities with lots of rich clients, hedge funds make easy political targets, and a direct attack on them remains possible: Italy’s finance minister has called them “absolutely crazy bodies” which “have nothing to do with capitalism”.

Still, by any sober assessment hedge funds rank fairly low on the list of institutions that have posed a threat to the system in the past year. Nevertheless, the indirect effects of government action could make life difficult. Even if short-sale bans go, hedge funds will now think twice before betting against the shares of important industries. And if, as seems likely, bank-solvency rules are redesigned, capital charges for prime-broking operations could yet rise, causing a contraction in lending to hedge funds. At the very least, financing the most leveraged arbitrage strategies will be much harder.

Yet an even greater unknown for the industry is its customers’ reaction to a year of abysmal performance. Certainly hedge funds have, just, outperformed a weighted basket of stocks, bonds and commodities—which has fallen by 22%, according to Gavyn Davies, the co-founder of Fulcrum, an asset-management firm. But relative outperformance was never the stated objective of the industry.

Instead it made clients a different promise. The simple version of this was that hedge funds would produce consistent absolute returns whatever the condition of financial markets. That claim has been sunk. The more sophisticated expression of the promise was that hedge funds could produce “alpha” or returns that were attributable to skill rather than market risk. Alpha has always been a slippery concept: in theory there should not be much of it about and academics have struggled to find evidence that the industry consistently realises it for clients. That is one reason why fees were under pressure even before the crisis. Having compared actual industry performance with models that “clone” the risk profile of leading funds-of-funds, Narayan Naik, a professor at the London Business School, thinks the industry has failed to create alpha since the subprime crisis began in August 2007, despite outperforming many asset classes.

That could change, says Mr Naik. After the collapse of LTCM, and amid the chaos and opportunities that it created, hedge funds did clearly produce alpha for two years. The dislocation this time round, particularly for the prices of less liquid assets, is far more severe. The dramatic reduction in the number of hedge funds should make trades less “crowded”. Other market participants, such as the proprietary trading desks of banks, may withdraw, further thinning the ranks of the competition. Some of the hot money that poured out of hedge funds could easily return at the first sign of stability.

Yet if the surviving firms are to prosper in the long term, and maintain their lucrative fees, the industry will have to address the structural inadequacies exposed so cruelly by the crisis. These have made its performance highly vulnerable to financial contagion. It will have to diversify its funding away from short-term loans from investment banks. Most important, it will have to wean its clients off the notion that they can both enjoy excess returns and be free to withdraw their money at will. Hedge funds have not proven to be the systemic threat that many feared, but they have not had a good credit crisis. After all, about the most hollow achievement in finance is this: to provide absolute returns—but only when markets are going up.

Prime brokers

Do the brokey-cokey

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Where will hedge funds put their business in future?

IN, OUT, shake it all about. The fall of Bear Stearns earlier this year persuaded many hedge funds to switch to Goldman Sachs and Morgan Stanley as their prime brokers. The two firms are the industry leaders in the (once) lucrative business of providing hedge funds with financing, lending them shares for short-selling purposes, settling trades and housing fund assets. Lots more switched again once Lehman Brothers went bankrupt in September. This time, the flow was towards the banks, as hedge funds realised that the broker-dealer model was much wobblier than they thought. JPMorgan Chase, now the owner of Bear, has seen a 25% rise in prime-brokerage assets over the past few weeks.

The question is whether hedge funds will again return to the old Wall Street fold. Now that Morgan Stanley and Goldman Sachs have received the blessing of the American government, thanks to the capital injections announced this month, worries about counterparty risk have clearly diminished. Insiders report that customers are coming back.

There is still lots of work to do. For that blame Lehman, whose failure now hangs poisonously over the relationship between hedge funds and prime brokers. In Europe many funds found that the assets they pledged as collateral in return for financing from Lehman have become trapped in the bankruptcy process as administrators strain to work out which assets genuinely belong to clients. Worse still, many assets have simply disappeared, thanks to a standard industry practice called “rehypothecation”, in which prime brokers use clients’ collateral to raise financing of their own.

In the long term, hedge funds are agitating for a change in the bankruptcy laws, particularly in London, to make it easier for them to retrieve their assets. There is some wistful talk of creating electronic marketplaces for lenders and borrowers of shares. In the short term, funds still have to look to their prime brokers for comfort. Funds want to ensure that assets which have not been pledged for collateral are kept in segregated client accounts. They increasingly want these accounts to act like proper custody accounts, so that prime brokers have absolutely no claim over the assets in them. And once leverage returns, many will want far more control over how their assets are rehypothecated.

Goldman and Morgan Stanley are both perfectly capable of meeting these demands. They have sophisticated systems that make it easier to document which assets belong to which funds and to sweep money cleanly between accounts. Their hope is that they can win the bulk of a fund’s assets, with another bank or two acting as back-up brokers in case of need. But confidence in the former broker-dealers has been jolted. According to Larry Tabb of TABB Group, a consultancy, the winners are likely to be banks with large custody functions, such as JPMorgan Chase and Citigroup. So don’t be surprised if Goldman and Morgan Stanley turn around and acquire custodian banks of their own.

Emerging markets

A taxonomy of trouble

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How are emerging markets suffering? Let us count the ways

Illustration by S. Kambayashi



EVEN now, not every central banker is terribly impressed by the gravity of the financial crisis that has spread from Western banks to the emerging world's shares, currencies and credit markets. In India the United Forum of Reserve Bank Officers and Employees—the central bank's staff union—decided that October 21st was a good moment for its 25,000 members to abandon their posts in a dispute over pensions. The Reserve Bank of India (RBI) denounced it as an illegal strike. The union called it mass casual leave.

A few months ago, many emerging economies hoped they could take mass casual leave from the credit crisis. Their banks operated far from where the blood was being shed. The economic slowdown evident in America and Europe was regrettable, but central bankers in many emerging economies, such as India and Brazil, were busy engineering slowdowns of their own to reverse high inflation. They were more interested in the price of oil than the price of interbank borrowing.

This detachment has proved illusory. The nonchalance of the RBI's staff, for example, is not shared by the central bank's top brass, who, a day before the strike, cut the bank's key interest rate from 9% to 8%, having already slashed reserve requirements earlier this month. Their staff's complaint about pensions looked quaint on the day that Argentina's government said it would nationalise the country's private-pension accounts in what looked to some like a raid to help it meet upcoming debt payments. The IMF, which has shed staff this year because of the lack of custom, is now working overtime (see article). The governments of South Korea and Russia have shored up their banking systems. Their foreign-exchange reserves, $240 billion and $542 billion respectively, no longer look excessive. Even China's economy is slowing more sharply than expected, growing by 9% in the year to the third quarter, its slowest rate in five years.

The emerging markets, which as the table shows enter the crisis from very different positions, are vulnerable to the financial crisis in at least three ways. Their exports of goods and services will suffer as the world economy slows. Their net imports of capital will also falter, forcing countries that live beyond their means to cut spending. And even some countries that live roughly within their means have gross liabilities to the rest of the world that are difficult to roll over. In this third group, the banks are short of dollars even if the country as a whole is not.

Long before Lehman Brothers went bankrupt in mid-September,

prompting the world’s money markets to seize up, the currencies of commodity exporters had already started to tumble. South Africa, a huge exporter of platinum and gold, has seen its currency fall further than any other this year except the Icelandic krona. Russia’s rouble peaked on July 16th as oil prices fell, and the Brazilian real began to slip a couple of weeks later.

Particular miseries

Emerging markets economic indicators, latest

	Exchange rate*	Current account, % of GDP 2008†	Foreign-exchange reserves‡, $bn	Foreign assets as % of liabilities§
Brazil	-24.8	-1.6	206	51
China	6.9	8.5	1,906	363
Hungary	-19.2	-5.9	25	49
India	-20.1	-2.9	283	*na*
Russia	-8.7	6.2	542	56
South Africa	-38.7	-7.7	31	128
South Korea	-31.3	-3.3	240	41
Ukraine	-13.0	-7.0	37	23

Sources: Economist Intelligence Unit; Goldman Sachs; JP Morgan; Thomson Datastream

*% change against the dollar Jan 1st-Oct 22nd 2008 †Forecast ‡Excluding gold §For local commercial banks

Brazil’s commodity exports amount to 9% of its GDP, according to Lombard Street Research, a firm of analysts. But its commodity firms, such as the oil giant Petrobras, account for over 40% of the stockmarket. Thus the fall in commodity prices has hit the bourses hard. A similar fate befell Russia, where the main indexes were already in decline after the country’s military misadventures in Georgia.

India and China benefit from cheaper oil. India, for example, spent almost two trillion rupees ($48 billion) on crude imports in the five months from April to August. But even as their import bills fall, their export earnings are slowing. On October 22nd Tata Consultancy Services, India’s biggest information-technology company, announced that its net dollar profit in the latest quarter was almost 7% below the quarter before. India’s IT bosses are worried about getting paid by banks for work they have done for them. Goldman Sachs says that India’s trade deficit will subtract 1.5 percentage points from its GDP growth this fiscal year and next.

India’s exports will be helped by a declining rupee. China’s yuan, on the other hand, has held its own against the dollar, even as the greenback has strengthened recently. It may find itself reprising its stabilising role during the Asian financial crisis, when it held fast to its dollar peg, even as its neighbours and competitors suffered currency collapses. Stephen Green of Standard Chartered calculates that China’s trade-weighted exchange rate, adjusted for inflation abroad and at home, is now at its strongest since 1989.

Morgan Stanley reckons the shares of emerging economies have never been as oversold. But foreign investors have punished some economies more harshly than others. The market for credit-default swaps, which insure against default on sovereign bonds has, for example, distinguished between countries running big current-account deficits (over 5% of GDP) and other more abstemious places.

Of the four biggest emerging markets, Brazil, Russia, India and China, India has the largest current-account deficit, which widened to 3.6% of GDP in the second quarter. It bridged most of this gap with foreign-direct investment. But its globe-trotting companies also rely on raising money abroad, borrowing $1.56 billion externally from April to June. This borrowing has since become far more expensive.

Russia has a hefty surplus on its current account, not a deficit. It earned $166 billion from oil and gas exports in 2007. Its economy should be flush with hard currency.

In fact, Russia’s companies and banks are now scrambling to find dollars. The overseas liabilities of Russian banks now exceed their foreign assets by $103.5 billion (excluding net foreign direct investment in the industry), according to the country’s central bank.

The country is not awash with petrodollars because the state taxes its energy earnings heavily, and sequesters its dollar takings in its central-bank reserves and its Stabilisation Fund. As Rory MacFarquhar of Goldman Sachs has pointed out, Russia accumulated $560 billion in foreign-exchange reserves from 2000 to mid-2008, even as its banks and companies have added $460 billion to their external debt. Russia, in effect, lends dollars to Western governments, then borrows them back again from Western banks.

Now those Western banks are suddenly reluctant to lend, which means Russia’s government will have to close the dollar-circuit itself. The central bank will deposit $50 billion of its foreign-exchange reserves in the state-owned Vnesheconombank, which will, in turn, lend that money to companies and banks faced with imminent foreign-debt payments.

There is an irony here. The West’s financial institutions have long been hoping for sovereign-wealth funds, flush with petrodollars, to arrive as saviours. But Russia, at least, now needs all its sovereign wealth to save itself.



FINANCE & ECONOMICS

The IMF

No strings attached

Oct 23rd 2008
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The fund is back. It needs to keep alert

Correction to this article

EPA



Strauss-Kahn—but shouldn't have

UNTIL last week, the IMF had been embarrassingly absent from the financial turmoil. Instead, it was just embarrassed. Rather than discussing rescue packages for troubled countries, most of the talk had been over the severance package offered to a former lover of its managing director, Dominique Strauss-Kahn.

Now, as one country after another descends into crisis, the world's economic firefighter has at last been called into action—despatching teams to parts as different as Iceland and Pakistan. As *The Economist* went to press the IMF was close to announcing details of a $1 billion package for Iceland, part of a $6 billion lifeline with contributions from the other Nordic countries and Japan. Pakistan may get $10 billion over two years. A $14 billion package for Ukraine is likely. Other countries talking to the fund include Belarus, Bulgaria, Hungary, Romania and Serbia.

The reasons for their vulnerability vary. Eastern European countries talking to the fund are disproportionately dependent on external financing and foreign banks. Pakistan's foreign-exchange reserves have dwindled as remittances and foreign investment have dried up. Iceland's troubles began with the collapse of an over-leveraged banking system.

The IMF remains the institution most suited to dealing with such crises. It has $255 billion in uncommitted usable resources and the ability to elicit funds from countries that may be reluctant to act on their own—as with the Japanese and Nordic contributions to the Iceland package. The IMF-led route is better for troubled countries than making ad hoc approaches to others. Even so, Pakistan first sought an emergency infusion of between $2 billion and $4 billion from the Chinese government, and Iceland tried to work out a deal with Russia. It was only after these attempts fell through that the two countries approached the IMF.

In part, their reluctance is a sign of the stigma of an IMF bail-out. The delay can cost valuable time while countries scramble to find other sources of help. Governments also worry about the damaging domestic political fallout of being forced to accept tough conditions as part of a rescue package. Critics have argued that the IMF is overly hung up on conditionality—although, in countries like Pakistan and Ukraine, which have enormous deficits, the need for conditions is clear. More generally, however, the fund needs to be flexible and it has indeed rethought its approach in recent years. It now aims to impose policy prescriptions only when absolutely critical to a programme's success. Details emerging from the talks with Iceland suggest these guidelines are being followed: there appear to be no punitive strings attached. That will help the IMF dispel concerns that it is too rigid in its ideology.

There are also doubts about whether the IMF's instruments are quick and flexible enough for the full range of crises. The mainstay of IMF crisis lending to emerging economies is the Stand-by Arrangement, which is designed for dealing with short-term balance-of-payments problems, but not necessarily with shortages of liquidity. The fund is thinking about a special short-term liquidity instrument, somewhat like the swap lines recently extended among central banks. But it has been slow in coming.

The fund needs to move fast, to use the right tools, and to propose policies that are tailored to each country's economic situation. There could be no worse time to be investigating whether Mr Strauss-Kahn broke the rules in his affair with a former staffer from Hungary. Just now Mr Strauss-Kahn needs his wits about him. Clearly, he can be easily distracted.

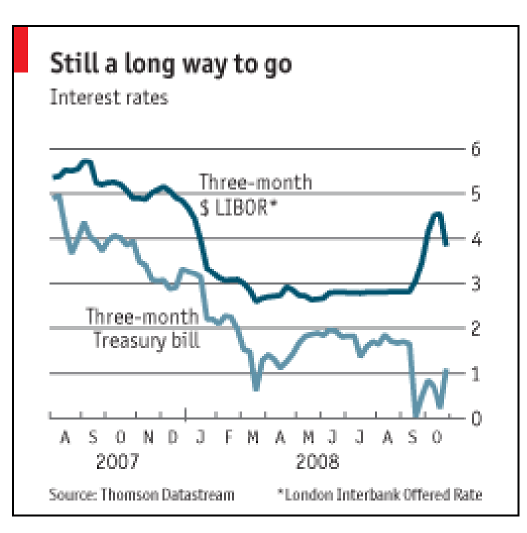
Correction: we mistakenly included Latvia in the list of countries that are talking to the IMF. This was corrected on October 24th 2008.

Money markets

Thawing out

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From The Economist print edition

Trust and money are beginning to run through the system again



THE world's banking system may still be in intensive care, kept alive with the help of generous infusions of state capital and liquidity. Yet there have been hopeful—albeit tentative—signs of recovery.

One indicator of its health is the price that banks say they expect to pay to borrow money for three months, which is usually expressed as the London Interbank Offered Rate (LIBOR). These have been ticking down slowly, often by only fractions of a percentage point a day. Yet on October 21st the rate for borrowing euros passed an important milestone, falling to 4.96%, a level last seen before Lehman Brothers collapsed in mid-September. The LIBOR spread over three-month American Treasury bills has also narrowed sharply (see chart). This week's improvements were partly stirred by the latest lavish intervention from the Federal Reserve. It made available $540 billion to buy assets from money-market funds, to encourage them to start buying commercial paper issued by banks and companies again.

The drop in money-market rates is hesitant. On October 23rd they crept higher in Asia. But the pace of Libor's recovery may actually be faster than meets the eye. When markets were at their most stressed it underestimated the full cost to banks of borrowing. The rates now being paid by banks to borrow may actually be half the level during the most intense moments of panic earlier this month.

More importantly, money is once again starting to flow through the system. "Compared with three weeks ago borrowing volumes are up by as much as ten times," says Tim Bond of Barclays Capital.

The trouble, however, is that the banks still need a lifeline from central banks, which have opened the floodgates of dollars and euros. The European Central Bank, for instance, has lent €773.2 billion ($1.02 trillion) to banks.

The best indicator of a healthy financial system is banks once again lending money to one another. There is improvement here, too. American banks including JPMorgan Chase and Citigroup have, in the past week, made loans to European counterparts for up to three months. And Europe's biggest bank, HSBC, is lending billions to other banks.

Markets for longer-term credits for banks are also gradually returning to life as institutional investors regain their nerve. On October 17th Lloyds TSB managed to sell £400m ($690m) of ten-year bonds—the first such issue by a European bank since the collapse of Lehman. As of October 22nd Barclays was planning to borrow €3 billion over three years by issuing notes backed by the government. But the cost of borrowing remains uncomfortably high. Lloyds TSB, for instance, paid 2.25 percentage points above the interest rate on an equivalent government bonds. Meanwhile, banks are exposed to further possible write-downs which could strain money markets once more. More businesses are going bust, which will put further pressure on the vast credit-derivative markets. Consumer loans are souring. If another big bank were to fail, the financial system might yet be back on life support.

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Bank regulation

Mewling and puking

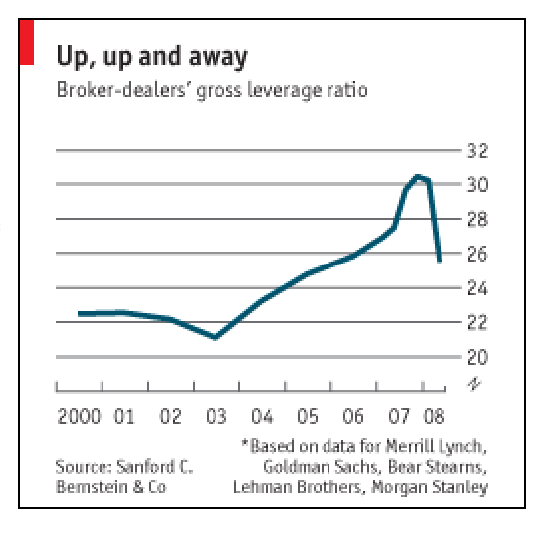
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How damaged is the Basel 2 accord?

NEWBORNS are usually cooed over. The Basel 2 accord, a set of rules on banks' capital adequacy, has had a much harsher reception. Never mind that the accord came into force across Europe only at the start of this year, and is due to arrive in America at the start of next. In theory and in practice, Basel 2 is under attack.

Theory first. The aim of Basel 2 is to align the amount of capital that banks set aside to absorb unexpected losses with the amount of risk that they are taking. The accord's predecessor, Basel 1, had the same goal, but took a cruder approach to calculating the riskiness of banks' assets. Basel 2 tries to be much more sensitive in its sums, rewarding banks that take fewer risks with lower capital requirements. That sounds unobjectionable (although by jacking up the amount of leverage that banks have, some argue that lower capital ratios simply send risk higher again).

The trouble is that the accord hands much of the responsibility for assessing risks to credit-rating agencies and the banks themselves. The credentials of both as risk managers now look more than a little tatty. Critics point to the experience of the broker-dealers in America as proof of Basel 2's flaws. A rule change in 2004, which allowed the Wall Street firms to use the new calculations, showed that they continued to be well capitalised on a risk-adjusted basis even as they drove their absolute levels of leverage sky-high (see chart). For three of the five broker-dealers, that had fatal consequences.



In practice, too, Basel 2 is looking less relevant by the day. Government recapitalisation of the banking industry continues apace. On October 19th ING announced that it was taking a €10 billion ($13 billion) dollop of cash from the Dutch government. The following day the French government allocated €10.5 billion of capital among six of its banks. BayernLB become the first German bank to request money from a state fund on October 21st. One curious result of all this intervention, says one Basel buff, is to make it hard to work out just how risky assets are now that the state is underwriting the system. A more substantial effect is to drive capital ratios well above the minimum levels required by Basel 2. The average tier-one ratio (of capital to risk-adjusted assets) in Europe now stands at 8.5%, far in excess of the accord's 4% floor.

Regulators are scrambling to adjust. Steps have already been taken to strengthen risk charges for assets held in banks' trading books and to improve banks' liquidity management. Discussions on how to dampen the procyclical effects of the accord, whereby risks appear to diminish during a boom, are also well under way. But its defenders still argue that the core principles of Basel 2 are intact. Encouraging banks to think harder about risk management is as desirable as ever. Forcing the banks to hold higher levels of capital is perfectly consistent with the goal of more accurately capturing the risks that they take.

Basel 2 certainly does a better job than its forerunner, particularly in areas such as banks' off-balance-sheet exposures. The new accord's framework also has the great merit of being flexible. Among its three main components, or "pillars", is one that allows national supervisors to turn the screw on capital as necessary. As for the unfortunate effect on Wall Street, the regime was not designed to be used by investment banks that only had mark-to-market trading-book exposures. Even opponents of the accord say that the American firms' regulator, the Securities and Exchange Commission (SEC), ought to have been much more careful in moving banks on to the new rules.

But claims that Basel 2 has suffered only flesh wounds look Pythonesque. The idea that a risk-weighted

capital measure needs to be backed up by something else is gaining ground. “More fences are better than fewer fences,” says Brad Hintz of Alliance Bernstein, a research firm. Swiss regulators have put the boot in by requiring that their biggest banks introduce a leverage ratio, a measure of capital that does not allow for any risk-weighting of assets. The ratio is not incompatible with Basel 2 but it is at odds with the underlying ethos: American lobbyists failed in their calls for an international leverage ratio before the crisis.

Worries that Basel 2 takes insufficient account of systemic risks are also in vogue. Till Guldimann of SunGard, a technology company, thinks that regulators need to borrow from other disciplines, such as computing and biology, to capture the idea of network effects between financial institutions. Others want to see a systemic capital charge based on overall asset growth, which would help banks to strengthen buffers in good times. As world leaders talk up the need for a new financial architecture, more reforms will be mooted. If it is to survive, Basel 2 needs to grow up fast.

Buttonwood

Margin for error

Oct 23rd 2008
From The Economist print edition

Banking profits have already suffered. Now it is the rest of the market's turn

Illustration by S. Kambayashi



THE global economy is slowing and many countries are either already in recession or about to enter it. Investors are well aware that the downturn will clobber corporate profits. But how great will the impact be and how much is already reflected in share prices?

The issue is all the more pressing because profits have been so strong in recent years. After falling sharply in 2000-02, earnings rebounded very rapidly between 2003 and 2006. Indeed, as a percentage of GDP, American profits reached their highest level in a generation. A lot of money now rides on whether that improvement was ephemeral.

American firms are now reporting on the July-to-September period and it looks likely to be the fifth quarter in a row that earnings will decline. Two leading technology companies, Texas Instruments and Sun Microsystems, were among the latest to disappoint this week.

Profits tend to fall very rapidly in recessions. This is because of the "operational gearing" of businesses. Most companies have high fixed costs; once those costs are covered, profits can surge. When economies contract, revenues fall and firms are usually slow to cut their fixed costs (by closing factories or laying off workers) so the effect on profits is savage.

Even now, however, with a downturn under way, industry analysts have been reluctant to cut their forecasts for the earnings of the companies they cover. Exclude financial services and Brian Belski of Merrill Lynch notes that consensus forecasts suggest American companies will still record 9.3% annual profits growth in the third quarter. More remarkably, profits are expected to rise a further 11.8% in 2009.

That seems most unlikely. Indeed, the downturn could be unusually sharp. First, the slowdown seems to have spread across the developed economies and has affected emerging markets as well. Companies that were relying on export growth to compensate for sluggish home markets are now starting to suffer. Second, the credit crisis will impose further strains, increasing financing costs as companies roll over their debts. Third, the recent fall in commodity prices will hit energy companies, some of the biggest contributors to profits growth this year.

Those strategists who take a "top-down" view of the outlook are accordingly more pessimistic than some of their analyst colleagues. Ian Harnett of Absolute Strategy Research, a consultancy, says European non-financial companies are likely to suffer a 30% drop in margins, given the economic outlook; this could translate into a 50% decline in profits over the cycle. Morgan Stanley strategists are predicting a further 10% decline in American corporate profits next year.

How much of this is priced into markets? The answer varies a lot from country to country. James Montier of Société Générale reckons that, notwithstanding bullish industry analysts, Wall Street as a whole is anticipating a 20% slump in profits next year. Karen Olney of Merrill Lynch says European shares are trading on a 38% discount to normal valuations whereas the average profits fall during the past four recessions has been 34%. Morgan Stanley calculates that emerging markets are discounting a 50% decline in earnings per share. While that sounds hugely pessimistic, the decline in 1997-98 was actually worse, with profits falling 67%.

Investors care not just about the size of the decline, but the speed and scope of any subsequent rebound. Their peace of mind probably depends on what drove the profits growth of 2003-06. At the time it was argued that globalisation had boosted capital relative to labour, by allowing companies to outsource

functions to developing countries.

The scale of the stockmarket decline suggests investors are no longer convinced of that reasoning. Peter Oppenheimer, a strategist at Goldman Sachs, argues that “the markets are assuming that all of the structural benefits of globalisation have been whittled away and will not be repeated.”

Perhaps company profits were boosted by temporarily low borrowing costs or by dodgy accounting (as in the late 1990s). If so, then a recession may reveal more Enrons and WorldComs—to name just two of the companies that collapsed in the aftermath of the dotcom bubble earlier this decade. Philip Isherwood, a strategist at Dresdner Kleinwort, reckons that almost a third of European companies have balance-sheets that put them at risk of financial distress.

In short, although investors may be braced for bad news at the aggregate level, there is a lot of scope for individual companies to shock. As the saying goes, “Recessions uncover what auditors do not.”

Wall Street on trial

Hunting for scalps

Oct 23rd 2008 | NEW YORK
From The Economist print edition

The pressure for convictions is great but prosecutors have their work cut out

AMERICANS are turning creative as they strive to make sense of the crisis. On October 29th a group of artists will stage a “literal meltdown” by placing a 1,500lb (680kg) ice sculpture of the word “economy” in Manhattan’s Foley Square. The installation will, according to one collaborator, “metaphorically capture the results of unregulated markets.” For many, though, catharsis will come only through another capture: the arrest and courtroom humiliation of the erstwhile Wall Street titans the public holds responsible for the mess.

In today’s political climate, the government will feel immense pressure to put a few moneymen in the dock. The FBI alone is probing more than two dozen firms. Market regulators, state attorneys-general and the Department of Justice are also jostling to unearth wrongdoing, sifting through e-mails and seeking whistle-blowers at firms such as Fannie Mae, American International Group and Lehman Brothers, the only Wall Street firm allowed to go bust. At least 17 former Lehman executives, including Dick Fuld, once its boss, are expected to receive grand-jury subpoenas.

Investigators are likely to focus mainly on disclosure and valuation. Ken Lay, boss of Enron, the failed energy giant, was convicted in part because of upbeat public statements he made even as he knew the firm was in trouble. Some may try to draw a parallel with Lehman, which said its capital position was “strong” just days before it filed for bankruptcy.

But to constitute fraud there must be intent to deceive. Proving that beyond reasonable doubt may not be easy, even to a jury disinclined to give fat cats the benefit of the doubt. Likewise, sloppy risk management, though lamentable, is not illegal. Paradoxically, the severity of the financial storm could help defendants. “As the crisis has grown, it has become harder for prosecutors to charge that any single firm has committed fraud,” argues Robert Giuffra of Sullivan & Cromwell, a law firm.

Moreover, showing that executives deliberately overvalued complex mortgage securities could be hard. Those accused of masking losses can point to the continuing debate over mark-to-market rules, which regulators recently relaxed—though any e-mails that reflect internal doubts about marks could “create smoke”, says Mary Jo White of Debevoise & Plimpton, another law firm.

The legal climate has shifted in favour of corporate defendants, too. Some aggressive tactics used by prosecutors after the bursting of the dotcom bubble have been curbed: for instance, firms can again cling to attorney-client privilege—the right to keep their communications confidential—without it being viewed as unco-operative by the authorities. New sentencing guidelines means 25-year jail terms are less likely. In civil cases three Supreme-Court rulings have made fraud harder to prove.

Investigators are yet to turn up clear evidence of unethical behaviour, let alone anything that warrants a long stretch in jail. They have a lot more digging to do—witness the subpoenas just handed to analysts who covered Lehman, requesting information that might suggest they were misled. They may find dirt—but it will be harder to make it stick.

Asian credit markets

Belly ache

Oct 23rd 2008 | HONG KONG
From The Economist print edition

The credit crisis is hitting Asia where it most hurts—trade

Reuters

LITTLE by little, the credit crisis is causing problems in the belly of Asian business. On October 20th CITIC Pacific, a Chinese conglomerate, stirred fears about the hedging strategies of companies across the region when it revealed a potential $2 billion loss caused by a bad bet on currencies. It is being investigated by Hong Kong's authorities amid concerns that it failed to reveal the loss quickly enough.

Also, two big Chinese companies, Smart Union, a toymaker, and FerroChina, a steelmaker, have gone into default this month, as have three Hong Kong retailers. Each, unable to find funding, had become increasingly slow to pay its suppliers. That problem is becoming pervasive, says the regional manager of an industrial-packaging operation, which puts an additional squeeze on business prospects.

Technically, the local banking system in Asia should be healthy enough for banks to continue to lend. With the exception of those in South Korea, Australia and Pakistan, most banks can finance all their loans with deposits, which puts them less at risk from strained money markets. They are well capitalised and profitable. That, however, has not stopped fear-induced glitches. Several weeks ago, Chinese banks briefly cut off credit to international banks before the government intervened. At least one Hong Kong bank is still holding back from resuming normal credit transactions with its American counterparts.

International banks are being even tougher with their clients. An executive at a big global bank says that credit lines are being trimmed, except for those to the largest and most established businesses. There are three reasons for this. The most important is that many banks do not have the funds to lend: the massive charges taken for bad loans in their home markets have reduced capital, even after the recent lifelines from Western governments and a few brave investors. Banks are also hoarding their cash, aware how precious it is. Risk, too, is being repriced, even in areas as supposedly safe as trade credit.

That is where Asian companies are most vulnerable. Instead of relying on broad capital markets as is common in American and Europe, they seek credit in more traditional ways: bank loans, the sale of discounted receivables, and letters of credit. One trading company based in China says the collateral required for a letter of credit—typically a safe kind of loan because it involves merely delivering something to a customer—has jumped from 25% to 50% of the stated amount. An odd beneficiary of this squeeze has been the dollar, since orders are increasingly being settled in cash.

In recent weeks, talk has grown of container-loads of goods unable to travel to America and Europe because they cannot be financed. More recently, there have been reports that traffic is stalled the other way. Several ship brokers refer to a vast order of scrap metal stuck on America's West Coast that was bound for China. Some of the disruption is an inevitable consequence of faltering demand as the world economy slows; some traffic will be liberated as a result of the thaw in interbank-lending markets. A good measure of the environment is the spot rate for carriage on container ships; it has crashed. These same rates in the forward market suggest only the most modest recovery in years to come. There is little reason to hope confidence in Asia will rebound soon.

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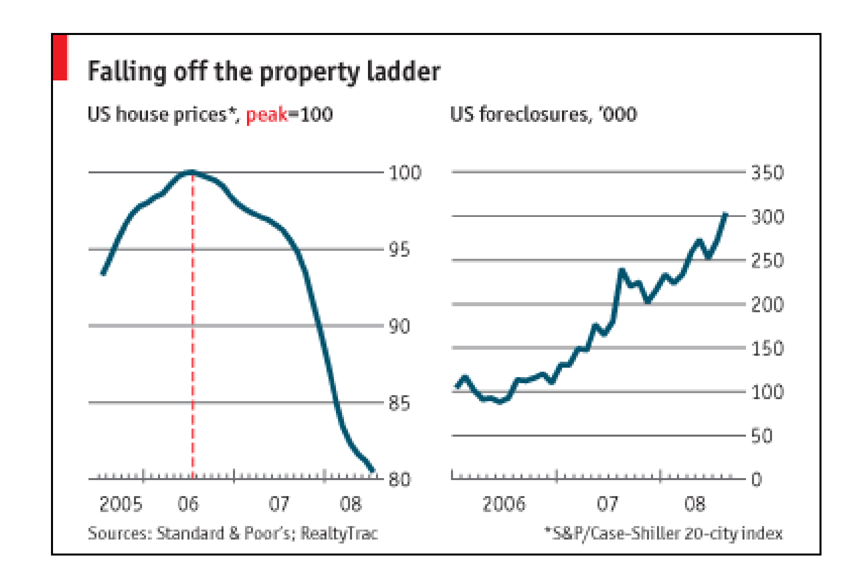
Economics focus

A helping hand to homeowners

Oct 23rd 2008
From The Economist print edition

Some economists think the credit crisis needs to be fixed at its source—in America's housing market

GOVERNMENTS across the rich world have taken drastic steps to save the banking system. As the fears of outright collapse recede, their focus has turned to improving the supply of credit to households and firms by pushing market interest rates down and encouraging banks to lend more freely. But a growing number of economists, and now the Bush administration, believe that the credit crunch also has to be addressed at its source—in America's housing market, where prices have fallen almost one-fifth from their peak, and foreclosures have soared (see chart).



Two features of housing finance make the crisis hard to resolve. The first is "no-recourse" home loans, which are standard in America (though not elsewhere). If a borrower defaults, a bank can claim back the property used as collateral, but nothing more. When the value of a home drops below the size of the mortgage, a borrower has a reason to default to escape his negative equity.

Borrowers' freedom to disown their bad housing investments means the housing slump feeds on itself. A lender may recover as little as half the value of the mortgage from a foreclosure, after legal and other costs, because abandoned homes quickly fall into disrepair and can only be sold at a discount. And foreclosures intensify house-price falls by adding to the stock of unsold houses. An enlightened bank may be better off forgiving a part of a mortgage if that persuades borrowers to remain in their homes. But that route is often closed off because of a second feature of the housing market: securitised mortgages. When a troubled home loan is in a pool with other mortgages, held by a group of investors, there is no easy way to agree on a deal to forgive debt.

In response to this problem, Luigi Zingales, of the University of Chicago, thinks the government should temporarily impose a standardised way to rejig the terms of securitised mortgages. He proposes that a 20% fall in a neighbourhood's house prices from the time when the borrower bought his house would automatically trigger an option to alter the terms of a loan. Lenders would be forced to write off a chunk of the original loan, shrinking the mortgage in proportion to the fall in house prices. In return they would receive a share of future house-price gains.

There are alternatives. Martin Feldstein, who chaired Ronald Reagan's Council of Economic Advisers (CEA) in the early 1980s, suggests creating "mortgage-replacement" loans to prevent distressed homeowners walking away from their debts. Under the plan, the government would provide low-cost loans to all mortgage holders, worth 20% of their outstanding mortgage debt.

The bait for homeowners would be lower interest costs. Mr Feldstein thinks the scheme's loans would need to have a fixed interest rate of around 2% to make a material dent in debt-service costs. In return borrowers would take on a slice of debt that they cannot welsh on: the replacement loan would not be secured on the home, but the government would have first claim on the borrower's future earnings in the event of a default.

Lenders would benefit because the replacement loan would create a much larger cushion against default on the original mortgage. And the government would get something back for its money, since the loan subsidy would help stem the tide of defaults, prevent further fire-sales of empty houses and make mortgage-backed assets less risky for banks to hold.

If banks won't lend, Fannie may

Another former CEA chairman, Glenn Hubbard, along with his Columbia University colleague, Chris Mayer, take a more radical approach. House prices could collapse, they reckon, because the downward pressure from foreclosures is made far worse by the scarcity and expense of home loans. To address this, the government should use Fannie Mae and Freddie Mac, the nationalised mortgage giants, to provide home loans to new and existing borrowers on terms that would be available if markets were working normally. They reckon the cost of a 30-year fixed-rate Fannie or Freddie mortgage is normally around 1.6 percentage points above the yield on ten-year government bonds, currently 3.7%. So the government could offer a benchmark 5.25% mortgage deal—matching the lowest rate in the past 30 years.

The Hubbard-Mayer scheme would be costly, since Fannie and Freddie could not lend to householders with negative equity—otherwise their new mortgages would be too small to pay off the old ones. Writing off negative equity could cost as much as $600 billion. Their benchmark for a "normal" credit spread is probably too low, since it is partly based on a period when risk was underpriced. Banks would also suffer from seeing profitable customers lured away by the offer of cheaper state-backed home loans. It would direct a lot of fiscal firepower at indebted homeowners, but would benefit other taxpayers only indirectly—a shortcoming it shares with Mr Feldstein's scheme.

Allied to that objection is a bigger one: attempting to put a floor under house prices (or any asset prices) is hugely distortionary. For his part, Mr Feldstein emphasises that his aim is not to prop up inflated home values artificially. "I don't want to stop a needed adjustment in house prices, but I don't want that adjustment to overshoot because of foreclosures." He believes the credit crisis will not be resolved until the incentive for borrowers to default—a uniquely American problem—is addressed. The proportion of underwater home-loans would double to around 40%, he reckons, if house prices fall by a further 15%—a drop that is widely forecast. If a fresh wave of borrowers hand back their house keys to lenders, it would leave many more mortgage-backed securities impaired than could be absorbed by the government's Troubled Asset Relief Programme (TARP).

Given the extent of negative equity and the risk of a negative spiral of defaults and falling prices, efforts to keep homeowners in their homes may yet be necessary to solve the crisis. Mr Zingales's proposal looks neatest. It would cost less, leaving resources free for a more general fiscal stimulus. But it won't be entirely costless: any forced renegotiation, even a relatively cheap one, may well lead to a higher cost of credit in the future.

Surveillance technology

If looks could kill

Oct 23rd 2008
From The Economist print edition



Security experts reckon the latest technology can detect hostile intentions before something bad happens. Unless it is perfect, though, that may be bad in itself

MONITORING surveillance cameras is tedious work. Even if you are concentrating, identifying suspicious behaviour is hard. Suppose a nondescript man descends to a subway platform several times over the course of a few days without getting on a train. Is that suspicious? Possibly. Is the average security guard going to notice? Probably not. A good example, then—if a fictional one—of why many people would like to develop intelligent computerised surveillance systems.

The perceived need for such systems is stimulating the development of devices that can both recognise people and objects and also detect suspicious behaviour. Much of this technology remains, for the moment, in laboratories. But Charles Cohen, the boss of Cybernet Systems, a firm based in Ann Arbor, Michigan, which is working for America's Army Research Laboratory, says behaviour-recognition systems are getting good, and are already deployed at some security checkpoints.

Human gaits, for example, can provide a lot of information about people's intentions. At the American Army's Aberdeen Proving Ground in Maryland, a team of gait analysts and psychologists led by Frank Morelli study video, much of it conveniently posted on the internet by insurgents in Afghanistan and Iraq. They use special object-recognition software to lock onto particular features of a video recording (a person's knees or elbow joints, for example) and follow them around. Correlating those movements with consequences, such as the throwing of a bomb, allows them to develop computer models that link posture and consequence reasonably reliably. The system can, for example, pick out a person in a crowd who is carrying a concealed package with the weight of a large explosives belt. According to Mr Morelli, the army plans to deploy the system at military checkpoints, on vehicles and at embassy perimeters.

Guilty

Some intelligent surveillance systems are able to go beyond even this. Instead of merely learning what a threat looks like, they can learn the context in which behaviour is probably threatening. That people linger in places such as bus stops, for example, is normal. Loitering in a stairwell, however, is a rarer occurrence that may warrant examination by human security staff (so impatient lovers beware). James Davis, a video-security expert at Ohio State University in Columbus, says such systems are already in use. Dr Davis is developing one for America's Air Force Research Laboratory. It uses a network of cameras to track people identified as suspicious—for example, pedestrians who have left a package on the ground—as

they walk through town.

As object- and motion-recognition technology improves, researchers are starting to focus on facial expressions and what they can reveal. The Human Factors Division of America's Department of Homeland Security (DHS), for example, is running what it calls Project Hostile Intent. This boasts a system that scrutinises fleeting "micro-expressions", easily missed by human eyes. Many flash for less than a tenth of a second and involve just a small portion of the face.

Terrorists are often trained to conceal emotions; micro-expressions, however, are largely involuntary. Even better, from the researchers' point of view, conscious attempts to suppress facial expressions actually accentuate micro-expressions. Sharla Rausch, the director of the Human Factors Division, refers to this somewhat disturbingly as "micro-facial leakage".

There are about 40 micro-expressions. The DHS's officials refuse to describe them in detail, which is a bit daft, as they have been studied for years by civilian researchers. But Paul Ekman, who was one of those researchers (he retired from the University of California, San Francisco, in 2004) and who now advises the DHS and other intelligence and law-enforcement agencies in the United States and elsewhere, points out that signals which seem to reveal hostile intent change with context. If many travellers in an airport-screening line are running late, telltales of anguish—raised cheeks and eyebrows, lowered lips and gaze—cause less concern.

Supporters of this sort of technology argue that it avoids controversial racial profiling: only behaviour is studied. This is a sticky issue, however, because cultures—and races—express themselves differently. Judee Burgoon, an expert on automated behaviour-recognition at the University of Arizona, Tucson, who conducts research for America's Department of Defence, says systems should be improved with cultural input. For example, passengers from repressive countries, who may already be under suspicion because of their origins, typically display extra anxiety (often revealed by rigid body movements) when near security officials. That could result in a lot of false positives and consequent ill-will. Dr Burgoon is upgrading her software, called Agent 99, by fine-tuning the interpretations of body movements of people from about 15 cultures.

Another programme run by the Human Factors Division, Future Attributable Screening Technology, or FAST, is being developed as a complement to Project Hostile Intent. An array of sensors, at a distance of a couple of metres, measures skin temperature, blood-flow patterns, perspiration, and heart and breathing rates. In a series of tests, including a demonstration last month with 140 role-playing volunteers, the system detected about 80% of those who had been asked to try to deceive it by being hostile or trying to smuggle a weapon through it.

A number of "innocents", though, were snagged too. The trial's organisers are unwilling to go into detail, and are now playing down the significance of the testing statistics. But FAST began just 16 months ago. Bob Burns, the project's leader, says its accuracy will improve next year thanks to extra sensors that can detect eye movements and body odours, both of which can provide further clues to emotional states.

Until proved innocent

That alarms some civil-libertarians. FAST, they say, amounts to a forced medical examination, and hostile-intent systems in general smack of the "pre-crime" technology featured in Philip K. Dick's short story "The Minority Report" and the film based on it. An exaggeration, perhaps. But the result of using these devices, according to Barry Steinhardt, the head of technology and liberty at the American Civil Liberties Union in Washington, DC, will inevitably be that too many innocents are entangled in intrusive questioning or worse with "voodoo science" security measures.

To the historically minded it smacks of polygraphs, the so-called lie-detectors that rely on measuring physiological correlates of stress. Those have had a patchy and controversial history, fingering nervous innocents while acquitting practised liars. Supporters of hostile-intent systems argue that the computers will not be taking over completely, and human security agents will always remain the final arbiters. Try telling that, though, to an innocent traveller who was in too much of a hurry—or even a couple smooching in a stairwell.

Lunar science

Lick that!

Oct 23rd 2008
From The Economist print edition

The search continues for moisture on the moon

ESA



Shackleton's icy depths?

WHAT, prithee, is awash with seas but hath no water? The answer, of course, is the moon. From the Ocean of Storms to the Bay of Rainbows, it is covered with features that are aqueous in name but not in nature. These lava plains, the result of meteoritic bombardment around 4 billion years ago, are all as dry as dust. Yet the hope remains that perhaps the riddle is not quite right, and that a little water (or, at least ice) might exist on the Earth's neighbour—perhaps enough to sustain a permanently manned moonbase, should anyone ever decide to build one.

That hope is focused at the moment on craters near the moon's poles, particularly one called Shackleton which has the south lunar pole within it. The location of these craters means that parts of their floors never see direct sunlight. So, if comets have landed there (and, given the craters' ages, the odds are that several will have), some of the ice carried by such dirty celestial snowballs might be preserved in the permanent shadow cast by the craters' walls.

Two past investigations have given comfort to the optimists. In 1994 a spacecraft called *Clementine*, launched by NASA, America's space agency, used radio waves to probe the moon's surface. After the mission was over, an analysis of the data suggested there were smooth areas in the craters at the south pole, referred to jokingly as "skating rinks", that might have been ice. In 1998 another craft, *Lunar Prospector*, detected hydrogen at both poles. This might (but might not) have come from water. On the other hand, ground-based radars have not been able to confirm *Clementine*'s observation of skating rinks.

The latest data, from a Japanese spaceship called *SELENE*, agree with the terrestrial radars. Junichi Haruyama, of the Institute of Space and Astronautical Science, in Sagamihara City, and his colleagues photographed places inside Shackleton that, though they receive no direct sunlight, do get a small amount of scattered illumination from other parts of the crater. The team's results, published in this week's *Science*, show no bright areas that might be bare ice. What this means is that ice, if it is there at all, must either be below the surface or be mixed with the lunar regolith—the crushed rock that passes for lunar soil—and thus be invisible.

The next step, according to Barbara Cohen, a self-confessed "lunatic" at NASA's Marshall Space Flight Centre, will be to look at data collected by *Chandrayaan 1*, which was launched on October 22nd. The craft is Indian, but NASA is hitching a ride. One of the instruments on board is an American spectroscope, the Mono Mineralogy Mapper. Even when this has reported, though, Dr Cohen reckons that it will not provide enough data to say, definitely, whether there is ice at the lunar poles.

But the *Lunar Reconnaissance Orbiter* (*LRO*), due to lift off next year, should. Its detectors will be able to tell whether the raised levels of hydrogen found by *Lunar Prospector* are confined to permanently shadowed regions, which is what would be predicted if they truly are a sign of water. The *LRO* will also use its instruments to build up a detailed picture of those regions, and will observe several smaller craft crash into them, in order to scan the resulting plumes of debris for water vapour. If it was there, that would be pretty conclusive. Dr Cohen, though, reckons that the only way to be sure there is ice on the moon is to go there and lick it yourself.

The evolution of homosexuality

Gender bending

Oct 23rd 2008
From The Economist print edition

Genes that make some people gay make their brothers and sisters fecund

THE evidence suggests that homosexual behaviour is partly genetic. Studies of identical twins, for example, show that if one of a pair (regardless of sex) is homosexual, the other has a 50% chance of being so, too. That observation, though, raises a worrying evolutionary question: how could a trait so at odds with reproductive success survive the ruthless imperatives of natural selection?

Various answers have been suggested. However, they all boil down to the idea that the relatives of those who are gay gain some advantage that allows genes predisposing people to homosexual behaviour to be passed on collaterally.

One proposal is that the help provided by maiden aunts and bachelor uncles in caring and providing for the children of their brothers and sisters might suffice. That seems unlikely to be the whole story (the amount of help needed to compensate would be huge), though it might be a contributory factor. The other idea, since there is evidence that male homosexuals, at least, are more likely than average to come from large families, is that the genes for gayness bring reproductive advantage to those who have them but are not actually gay themselves. Originally, the thought was that whichever genes make men gay might make women more fecund, and possibly vice versa.

Brendan Zietsch of the Queensland Institute of Medical Research in Brisbane, Australia, and his colleagues have, however, come up with a twist on this idea. In a paper to be published soon in *Evolution and Human Behavior*, they suggest the advantage accrues not to relatives of the opposite sex, but to those of the same one. They think that genes which cause men to be more feminine in appearance, outlook and behaviour and those that make women more masculine in those attributes, confer reproductive advantages as long as they do not push the individual possessing them all the way to homosexuality.

The straight truth

Other evidence does indeed show that homosexuals tend to be “gender atypical” in areas beside their choice of sexual partner. Gay men often see themselves as being more feminine than straight men do, and, *mutatis mutandis*, the same is true for lesbians. To a lesser extent, homosexuals tend to have gender-atypical careers, hobbies and other interests.

Personality tests also show differences, with gay men ranking higher than straight men in standardised tests for agreeableness, expressiveness, conscientiousness, openness to experience and neuroticism. Lesbians tend to be more assertive and less neurotic than straight women.

There are also data which suggest that having a more feminine personality might indeed give a heterosexual male an advantage. Though women prefer traditionally macho men at the time in their menstrual cycles when they are most fertile, at other times they are more attracted to those with feminine traits such as tenderness, considerateness and kindness, as well as those with feminised faces. The explanation usually advanced for this is that macho men will provide the sperm needed to make sexy sons, but the more feminised phenotype makes a better carer and provider—in other words an ideal husband. And, despite all the adultery and cuckoldry that goes on in the world, it is the husband who fathers most of the children.

As far as masculinised women are concerned, less research has been done on the advantages that their appearance and behaviour might bring. What data there are, however, suggest they tend to have more sexual partners than highly feminised women do. That may, Dr Zietsch speculates, reflect increased competitiveness or a willingness to engage in unrestrained sexual relations (ie, to behave in a male-like way) that other women do not share.

Dr Zietsch and his colleagues tested their idea by doing a twin study of their own. They asked 4,904 individual twins, not all of them identical, to fill out anonymous questionnaires about their sexual orientation, their gender self-identification and the number of opposite-sex partners they had had during the course of their lives. (They used this figure as a proxy for reproductive fitness, since modern birth-control techniques mask actual reproductive fitness.)

The rules of attraction

Their first observation was that the number of sexual partners an individual claimed did correlate with that individual's "gender identity". The more feminine a man, the more masculine a woman, the higher the hit rate with the opposite sex—though women of all gender identities reported fewer partners than men did. (This paradox is normal in such studies. It probably reflects either male boasting or female bashfulness, but though it affects totals it does not seem to affect trends.)

When the relationships between twins were included in the statistical analysis (all genes in common for identical twins; a 50% overlap for the non-identical) the team was able to show that both atypical gender identity and its influence on the number of people of the opposite sex an individual claimed to have seduced were under a significant amount of genetic control. More directly, the study showed that heterosexuals with a homosexual twin tend to have more sexual partners than heterosexuals with a heterosexual twin.

According to the final crunching of the numbers, genes explain 27% of an individual's gender identity and 59% of the variation in the number of sexual partners that people have. The team also measured the genetic component of sexual orientation and came up with a figure of 47%—more or less the same, therefore, as that from previous studies. The idea that it is having fecund relatives that sustains homosexuality thus looks quite plausible.

X-rays and sticky tape

See-through tape

Oct 23rd 2008
From The Economist print edition

One of the more unusual things you can do with a roll of adhesive tape is to take an X-ray photograph of your finger. Carlos Camara, Juan Escobar and their colleagues at the University of California, Los Angeles, report in this week's *Nature* that unwinding a reel of the stuff generates enough X-rays to do just that. Peeling tape from a reel results in a phenomenon called triboluminescence. The breaking of the intermolecular bonds that hold the layers of tape together releases energy in the form of light. That has been known since 1939. It has also been known since 1953 that the phenomenon extends to light's more powerful cousins, X-rays. What was not realised, until Dr Camara and Dr Escobar performed their experiment, was just how many X-rays are produced. Their automatic tape-unrolling machine made enough from a single reel to take a small X-ray photograph. Something to think about when wrapping a parcel.

Israel

Jewish and democratic

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Corbis



Two Israeli academics offer a robust and timely defence of the Zionist idea

Israel and the Family of Nations: The Jewish Nation-State and Human Rights
By Alexander Yakobson and Amnon Rubinstein



Routledge; 246 pages; $140 and £70

IT IS a little sad that Alexander Yakobson and Amnon Rubinstein felt the need to write this book. Is it really necessary, 60 years after Israel's birth, to argue the Zionist case all over again? Alas, yes.

Much legitimate criticism has rained down on Israel for its behaviour in the Arab territories it occupied during the six-day war of 1967. Lately, however, a new line of attack has returned to the fore. This is the notion that Israel is illegitimate by definition: that Zionism is "colonial", that Jews are adherents of a religion and not "a people", and that a country that defines itself explicitly as a Jewish state cannot be properly democratic or protect the rights of its Arab minority.

The question of whether the Jews are a people, with as much of a claim as any other to national self-determination, was examined intensively by the United Nations in 1947 in the debates that preceded Israel's creation, and answered in the affirmative. Although the Arabs never accepted the justice of the Zionist position, and the Iranians continue to argue for Israel's dissolution, what exasperates these authors is less the ranting from Tehran than the fact that quite a few Western intellectuals have come to a similar conclusion. In 2003 a British Jewish writer, Tony Judt, asserted in the *New York Review of Books* that a Jewish state, defined by him as "a state in which Jews and the Jewish religion have exclusive privileges from which non-Jewish citizens are forever excluded", was "an anachronism", and that the Jewish state should be replaced by a binational one.

Mr Yakobson and Mr Rubinstein are both Israelis, the former a historian, the latter a professor of law who served in the cabinet of Yitzhak Rabin. In rebutting the arguments of Mr Judt and others, their aim is not to whitewash Israel. They strongly oppose the colonisation of the West Bank and admit that, in practice, Israel's treatment of its Arab citizens has fallen far short of the standard that should be demanded of a liberal democracy. But however deficient the practice, they say, there is no reason in principle why Israel cannot be both a Jewish state and a democracy whose non-Jewish citizens enjoy full civil equality. On the contrary, they insist, it is those who do not accept the legitimacy of a Jewish state who undermine the

principle of equality, by denying to the Jews the right of self-determination they extend to others.

This book is being sold at a silly price. It is not an enjoyable read, and certainly not a light one. Its arguments are dense, dry and legalistic. But it is an important book, whose ideas deserve to be widely heard. By the end the authors have constructed a methodical defence not only of the Zionist idea but also of the two-state solution in Palestine, an idea which—six decades after the UN's partition resolution of 1947—is losing the support of some intellectuals but is still the most plausible way to reconcile the Jews and Arabs of Palestine.

Some say it was preposterous of the UN in 1947 to bring into being a Jewish state on the basis of a mystical land claim stretching back thousands of years. But this, as Messrs Yakobson and Rubinstein explain, is not what the UN did. Its decision was based hardly at all on the Bible and mostly on the political realities of the time: the actual presence in mandatory Palestine in the 1940s of two peoples whose equally authentic national aspirations seemed impossible to fulfil except by partition. The UN also noted that hundreds of thousands of displaced Holocaust survivors were desperate to leave Europe and they were welcome almost nowhere else. One reason the UN allotted about half the land to the Jews, even though they made up only a third of the population, was precisely to make room for the influx from Europe.

If partition was a pragmatic response to the reality of the time, a prior question is: by what right did the 600,000 or so Jews of mandatory Palestine come to be there in the first place? Unlike other peoples craving national self-determination after the first world war, the Jews were dispersed and had no territorial base. The Zionist movement had therefore to bring them to Palestine, a territory with a people of its own. That made Zionism different from other nationalisms. But should the fact that the Jews were homeless as well as stateless disqualify their claim to nationhood and set their rights at naught? No, say these authors: to take that view would be to punish the Jews for the tragedy of dispersion and deny a right they needed "more desperately than any other people" in the 20th century. The Jewish national claim, it is true, conflicted with the national claim of the Palestinians, but the equitable solution to that should have been, "from the outset, and not only after the fact", two states for two peoples.

If there is anything Jews and Arabs have agreed on during the conflict in Palestine, it is that they do not belong to the same people. So it is an irony, the authors observe, that the acceptability of a Jewish state should be called into question anew by sophisticated critics in the West just when most Israelis have come around again to accepting the need for a Palestinian one. The authenticity of Jewish peoplehood, with a national existence focused on Israel, is by now a fact of modern history, they say, and should no longer be a matter for ideological debate.

As for the oft-heard argument that it is impossible for Israel to be both a Jewish state and a democratic one, the authors will have none of this. In many democracies, the country's public character is determined primarily by the culture and identity of the majority of its people. Israel's Jewish character reflects the will of its majority, but on paper at least its Arab citizens are entitled to full political and civil rights. Nobody challenges the right of Israel's neighbours, including the putative Palestinian state, to define themselves as "Arab states", some with a special role for Islam, even though they contain large non-Arab minorities. The cross appears on the flag of umpteen European and other countries; in Israel's case alone is the fact that the national emblems are religious offered as evidence that the state is not democratic.

Israel's law of return, giving Jews an automatic right to citizenship, is likewise held up by critics as evidence of discrimination. But this law relates to immigration alone: it does not discriminate between different categories of citizens in Israel or make the rights of non-Jewish Israeli citizens inferior. Nor, say the authors, is it so exceptional. The contemporary democratic world provides numerous such examples of ties between nation-states and national diasporas. Germany, Greece, Finland, Poland and Armenia are among those which in different ways grant their "kin" abroad shortcuts to citizenship.

If the argument erected by the authors has a systemic flaw, it is the extent to which their defence of Israeli democracy puts the question of the occupied territories in a sort of parenthesis. Messrs Yakobson and Rubinstein happen to support a two-state solution, and note that most Israelis say they support it too. But the inescapable fact is that the Arabs of Palestine never got the state the UN promised them, and those in the West Bank and (until recently) Gaza have spent the past 40 years under Israeli military occupation, with no citizenship rights at all. That, the authors imply, is another story, separate from the one that interests them: the internal quality of Israeli democracy and the rights of Israel's own Arabs. In logic, maybe. But in the eyes of the Palestinians, and others, it is hardly surprising, after all the stateless decades, that the two stories have merged.

Israel and the Family of Nations: The Jewish Nation-State and Human Rights.
By Alexander Yakobson and Amnon Rubinstein.
Routledge; 246 pages; $140 and £70

"Things Fall Apart"

A golden jubilee

Oct 23rd 2008
From The Economist print edition

A birthday party for an African classic

AFP


Seeing light in language

CHINUA ACHEBE'S "Things Fall Apart", which celebrates its golden jubilee this year, is Africa's best known work of literature. The slim novel has been translated into 50 languages and has sold 10m copies. Never once has it been out of print.

Africa was on the cusp of change when the book first came out. A handful of African countries had already become independent by 1958, but few people would have predicted then what shape change would take elsewhere on the continent. Right from the book's very first line, "Okonkwo was well known throughout the nine villages and even beyond", the reader is also launched into uncharted territory. Who was this Okonkwo and why was he so well known? Who was it that knew him? With a heightened diction and extensive use of allegory and metaphor, Mr Achebe gave Okonkwo, a famed wrestler, a heroic mien. But he is mostly alone in trying to defend the traditional society in which he was born, and when his efforts fail, in bitterness Okonkwo hangs himself.

The allusion in the title to Yeats's poem, "The Second Coming"—"Things fall apart; the centre cannot hold"—signalled Mr Achebe's awareness that he was living at a crossroads in history, something he regards as being good for a writer and for which he has always been grateful.

The first person to read the manuscript was Gilbert Phelps of the BBC, whom Mr Achebe had met during a short visit to London. Excited by the novelty of a voice that was not a slavish copy of European literature, but something authentically African and new, Phelps sent it on to his own publisher, William Heinemann, with a note: "This is a very exciting discovery…It is full of characters who really live, and, once begun, it is difficult to put down."

Now known as the grand-daddy of African fiction, Mr Achebe has had a more difficult life. In 1990 he was involved in a car accident in Nigeria, and has since been a paraplegic. He and his wife, Christie, live in upstate New York, where he is professor of languages and literature at Bard College.

The golden jubilee of "Things Fall Apart" was presaged by the announcement in June 2007 that Mr Achebe had been awarded the second Man Booker international prize. In contrast to Man Booker's older and better known annual counterpart which lauds a single new book, the international prize celebrates an "achievement in fiction". Asked what the panel had been looking for among the 80-or-so living authors whose work was considered for the prize, Nadine Gordimer, the oldest of the three judges and the only Nobel-prize-winner, gave an immediate response: "illumination". For Mr Achebe, who has won his fair share of prizes over the years, the Man Booker was especially touching for being chosen by his peers.

Elegant in his wheelchair, dressed in his Nigerian chief's robes and his red domed hat, Mr Achebe has been receiving accolades the world over. The celebrations of the fiftieth anniversary of the book's publication began in Portugal. They continued in Texas and in Nigeria, where Mr Achebe's home village, Ogidi, dedicated the Mookoche festival, the Ibo people's Thanksgiving at the end of the rainy season, to "Things Fall Apart".

The festivities continued in London earlier this month where Mr Achebe was the guest of honour at a lunch at the House of Lords and then the subject of a two-day conference at London University's School of Oriental and African Studies. The highlight will be a ceremony early next month at the Library of Congress just before the author's 78th birthday.

For Mr Achebe, the end of the celebrations will mark a welcome return to his peaceful life at Bard College. “I feel the pressure of the paraplegia really cuts into my day,” he says. He is anxious to get back to work. An autobiographical essay, “Reflections of a British Protected Child”, about his childhood in the British Protectorate of Nigeria, is finished and now in the hands of his agent.

His next project will be to translate “Things Fall Apart” into his native Ibo for the first time. The translation Mr Achebe is striving for is not the Union Ibo that was imposed on southern Nigeria in the early 1900s by British missionaries bent on religious conversion and the distribution of the Bible. “Even my own village has words or expressions that are not used in a village two miles away.” For a writer for whom language and literary imagination are quite inseparable, Mr Achebe’s ambition is to find the inchoate languages, varying in detail from village to village, that were the heartbeat of the Ibo nation of his birth.

Alex the African Grey

My parrot and I

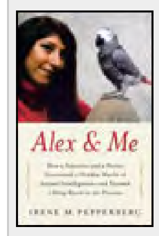
Oct 23rd 2008
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THE young Irene Pepperberg was not the only child to have been enthralled by the "Dr Dolittle" stories, in which a doctor is taught the language of animals by his parrot. But it is unlikely that anyone will match her tenacity in trying to make the stories come true. For the past 30 years, Dr Pepperberg, who studies parrots at Brandeis University in Massachusetts, has been producing research papers on the cognitive abilities of her African Grey, Alex, who died in September 2007 and who was the subject of an *Economist* obituary. In "Alex & Me" she has written a memoir of two unusual scientific careers, one of them pursued—not exactly by choice—by a bird.

Illustration by Daniel Pudles



Alex & Me: How a Scientist and a Parrot Uncovered a Hidden World of Animal Intelligence—And Formed a Deep Bond in the Process
By Irene M. Pepperberg



Collins; 232 pages; $23.95

Buy it at
Amazon.com
Amazon.co.uk

As a lonely child in Brooklyn, Dr Pepperberg owned pet birds from the age of four, and daydreamed about being able to understand animals' thoughts. A socially awkward chemistry student at the Massachusetts Institute of Technology (MIT) in Boston, she writes that talking to her parakeet was often her "only non-work-related exchange of the whole day". It hardly comes as a surprise that she decided to switch from chemistry to the study of animal communication. When a pet-shop owner picked out an African Grey for her in 1977, she says she already expected that it would come to change the way people thought about the minds of animals.

Thus she knew from the start what she wanted to prove. That may seem suspiciously overconfident, but Dr Pepperberg certainly obtained some striking results. Alex (his name supposedly an acronym for Avian Learning Experiment) eventually learned the names of about 50 objects, knew the numerals from one to six, could perform simple addition and used categories such as similarity and difference, shape, colour and material. He apparently combined words to make up his own expressions ("yummy bread" for cake, for example). He also seemed to combine phonemes to construct new words. Lacking lips, he could not pronounce the letter "p", so his term for an apple was "banerry" (apparently mixing "banana" and "cherry"). Most unnerving of all, he would make spontaneous remarks in appropriate circumstances, such as "What's your problem?" and "I'm gonna go away now."

The efforts required to bring forth such little marvels were immense. For the first 15 years of his life, Alex was talked to by his trainers for eight hours each day. Dr Pepperberg adapted the so-called "Model/Rival" method developed by a German ethologist in the 1970s; this uses two experimenters, one of whom, A, "teaches" the other, B, while sometimes switching attention to the parrot. In Dr Pepperberg's version, A and B alternate their roles, to mimic the social context in which children learn to speak.

Finding the money for such labour-intensive research has been a constant struggle, and Dr Pepperberg relies on private donors and the generous help of volunteers. There is little sign, however, that other labs will be able to devote the enormous efforts required to replicate her work, as scientific method requires. Unfortunately for Alex's legacy, this may mean that he comes to be remembered as little more than a unique curiosity.

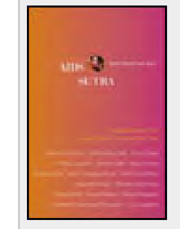
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AIDS in India

Sex and the poor

Oct 23rd 2008
From The Economist print edition

AIDS Sutra: Untold Stories From India
Edited by Negar Akhavi



Anchor Books; 334 pages; $13.95. Vintage; £8.99

Buy it at
Amazon.com
Amazon.co.uk

ONE of India's leading AIDS doctors, Alka Deshpande, did not choose her specialisation. Working as a hospital doctor in Bombay (now called Mumbai) in the late 1980s when AIDS was discovered in the city, she merely decided that she was prepared to touch the infected. Her colleagues would not do so—and perhaps still will not. According to a recent UN study, over half of Indian health-care workers thought AIDS was transmitted by touch.

In a mostly-Hindu society, which for thousands of years considered one-fifth of its members "untouchable", discrimination and ignorance of this kind have a particularly unpleasant significance. Indeed, the ways in which AIDS and India's traditions interact are a striking feature of these essays about the disease in India, commissioned by the Gates Foundation. On a tour through the south-eastern state of Andhra Pradesh, which has a fifth of India's estimated 2.5m HIV cases, Kiran Desai meets women of several hereditary prostitute castes, including relatively affluent beauties who are apparently not unhappy with their lot, as well as wretched sex slaves, pimped by their neighbours. AIDS haunts them all.

In Karnataka, a hilly southern state, William Dalrymple—the only non-Indian contributor to the collection—meets the inheritors of the now illegal tradition of temple prostitution. In ancient times, its practitioners included the daughters of royalty, dedicated in childhood to service the devotees of the goddess Yellamma. The modern lot almost all belong to a single caste of illiterate *dalits*. They are distinguishable from run-of-the-mill village prostitutes only by their early entry into the career and therefore a higher probability that they will contract HIV. Nearly 40% of Karnataka's *devadasis*—literally, slaves of god—are believed to be infected with the virus.

India's regulations against sodomy and soliciting are another ugly local feature. By criminalising gay sex and prostitution, these laws have blocked many sincere efforts to quell the virus. Among Bangalore's gay men, as described by Mukul Kesevan, one in five has HIV. They come in three categories: *kothis*, who specialise in being penetrated; *panthis*, who penetrate; and "double-deckers", who do both. The *kothis*, alas, seem a particularly woeful bunch. Many are rent-boys, perpetually terrorised and periodically raped by the police. Some are *hijras*, members of India's semi-ostracised "third sex". By contrast, *panthis*, the transmitters of the AIDS virus, often lead regular family lives.

Almost all these essays are about sex and poor people. There are two exceptions. One is an interesting story by Siddharth Dhanvant Shanghvi about the death of a gay film-maker in Mumbai from AIDS. The other, by Vikram Seth, is about his own awakening to the virus in California in the 1980s. Accompanying it is a poem that he wrote at the time, a dying man's meditation on death, which ends: "Love me when I am dead/And do not let me die." It is a moving plea.

More typically, these well-to-do writers seem to struggle for empathy with their wretched subjects. Sunil Gangopadhyay, a Bengali poet, succeeds better than most, with an engaging memoir of wanderings in Sonagachhi, the main red-light district of Kolkata (previously Calcutta). Ms Desai's essay is also finely observed: for example, a passage on the miseries of open-air prostitution, along a lonely coast-road, where a woman's price falls during the monsoon. Yet an awkward effort to write her father's terminal cancer into this narrative of suffering suggests her feelings of alienation from it. Sensibly, perhaps, Sir Salman Rushdie keeps his rather short dispatch from among the *hijras* of Mumbai more impersonal. Yet his contribution, which includes a description of a stiff, ex-army father's begrudging, but complete, acceptance of his *hijra* son, is one of the best.

AIDS Sutra: Untold Stories From India.
Edited by Negar Akhavi.
Anchor Books; 334 pages; $13.95. Vintage; £8.99

"Byzantium"

Domes of gold

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The Royal Academy's new show fails to do its exhibits justice

PA



OVER the past century, British scholarship has done a lot for the understanding of the Byzantine world, as though it was atoning for the calumnies of Edward Gibbon, chronicler of Rome's fall. It was a Russian-born Oxbridge don, Dimitri Obolensky, who in 1971 coined the term "Byzantine Commonwealth" to describe territories that formed a common cultural and spiritual space with Constantinople but were not subject to it politically; indeed these territories were often at war with the city on the Bosphorus.

Obolensky was influenced by the British empire's transformation into a commonwealth. But his idea also expressed a deeper paradox about eastern Christianity, which half-conceals its beliefs about the eternal—beliefs that transcend earthly limits, including political ones—under a cacophony of rival chauvinisms.

Obolensky's subtlety has not quite been matched by the designers of the Royal Academy's exhibition entitled "Byzantium 330-1453". The name will be a warning to some. In the spirit of 19th-century nationalism, it exaggerates historical continuity and affirms the myth that clearly defined "nations" and their empires as the building blocks of history and culture.

Well, it is true that in certain respects, the culture that flowered on the Bosphorus showed great continuity over time. Its public language, classical Greek, was self-consciously archaising, and its theology regarded innovation as a bad word. Certain artistic techniques, such as the use of gold, silver and ivory and above all the painting of icons and frescoes, remained at a consistent level of excellence, as the empire's political fortunes fluctuated. The exhibition has thrilling examples of this excellence, gathered from museums in America, Italy, Greece and the Balkans.

But anyone who overstresses Byzantium's continuity will struggle to cope with certain awkward "interruptions"—like the fact that 1,000 years ago, the word "Hellene" was used only in a negative sense, to denote someone who preferred paganism to Christianity. In other words, this was a world that defined itself in terms of faith, rather than by a "national" culture or language. Only after Byzantium's break with Rome in 1053 was there a re-emphasis of Hellenism over Christian universalism.

If that is too subtle a point to make in a show for non-specialists, then the stated aim of this exhibition may be too ambitious. In fairness, its organisers may feel they have done enough for the Byzantine world by dispelling some dark associations. Byzantium often gets a dreadful press: it is synonymous in many minds with palace intrigues, ending in matricide or mutilation. And it is historians of art, above all, who have persuaded the public that life on the Bosphorus had saving graces. For scholars in British universities who devote their lives to this fascinating, elusive world, this exhibition feels like an overdue vindication of their work. One of the best results of the show will be a series of public lectures by these dedicated dons.

And yet some visitors to the Royal Academy will be disappointed. Observing the presentation of items ranging from late Roman gravestones to an 11th-century incense burner (pictured at top) and Italo-Cretan religious art, they will note an emphasis on certain other "continuities" which implicitly downgrade Byzantium. What they seem to proclaim is not a distinct civilisation, but a worthy successor to ancient Rome, that later became a worthy precursor to the Renaissance.

Stress is laid on the commonality of subject-matter between pagan art and that of the early Christians;

we are told that “progressive” (sic) forms of Byzantine art foreshadowed Renaissance humanism. This ignores the argument made so boldly by a larger show on Byzantium at the Metropolitan Museum of Art in New York four years ago. The Met took seriously the eastern Christians’ claim to a distinct view of the relationship between man, God and the physical world: a view that would see Renaissance religious art as self-indulgent rather than “progressive”. An odd view, to most Westerners—but you can’t present Byzantium honestly without explaining it.

The exhibition’s showpiece will—it is hoped—consist of ten icons from St Catherine’s monastery on Mount Sinai, including famous ones of Moses and Archangel Michael. With their restrained excellence, all these works exemplify an eastern Christian view of matter and spirit that soars above national boundaries. It also stands by itself—in no need of justification by virtue of what it led to, or where it came from. But at the time of this week’s opening, the items from Mount Sinai had not yet arrived. Organisers are hoping that the Egyptian bureaucratic procedures will be cleared in the next week or two. Once they are displayed, these treasures will proclaim an eternal reality which did not end in 1453.

“Byzantium: 330-1453” is at the Royal Academy of Arts, London, until March 22nd

Ted Briggs

Oct 23rd 2008
From The Economist print edition

HMS Hood Association



Edward Albert ("Ted") Briggs, last survivor of the sinking of HMS Hood, died on October 4th, aged 85

TO DIE in a hospital bed was not the end Ted Briggs expected. He thought he had copped it when, at 16 and on Atlantic patrols on *HMS Hood* in 1939, he looked up to see a black object "as big as a London bus" tumble gently out of the sky and pepper the deck with shrapnel. Or, some months later, when a stick of bombs from an Italian aircraft blew him down the ladder from the flag deck, giving him a cut on the nose that bled like a torrent. Or the moment when, inching out along an upper yardarm to retrieve a halyard (for he was a signal boy), he saw the engine-room safety valves pump out a column of red-hot steam, and expected to be boiled alive.

The life of a boy-sailor on the navy's prize battlecruiser was no cakewalk. From Fall-in at 05.25 to Turn-in at 20.45—swinging into a hammock under a heavy wool blanket, his mouth still dry with gritty cocoa—came constant swabbing and scrubbing of the grey corticine decks, interspersed with instruction and drill. That was in time of peace. But Mr Briggs knew only two months of quiet before he was ordered to hoist flag "E" and "show up 46": "Commence hostilities against Germany."

He had not joined the Royal Navy to fight. He had joined because, one day in the summer of 1935, he saw from the beach at Redcar in North Yorkshire a long, slim, huge ship at anchor far away. It was the *Hood* on a visit to Hartlepool. Mr Briggs, a straightforward man, was embarrassed to mention her "beauty" and "grace", but that was what he felt. It was a love affair. He tried to join the navy the next day; a man told him, since he was 12, to come back later. The day he eventually went on board the *Hood*, at 16 at Portsmouth, was the time he first felt that peculiar mixture of queasiness and wild excitement that assailed him each time he was piped to Action stations and the big guns opened fire.

In his many writings and talks about the *Hood*, Mr Briggs recalled great happiness on board. Though patrols near the Arctic to intercept German ships brought mountainous seas and soaking, freezing spray, the "mighty *Hood*" was a vessel on which he felt cared for. He was proud of her and the tasks he did for her: officers' messenger to and from the cabins of the braided top brass, and signal boy, running up the flags as needed and securing them, on the high yardarms, with Inglefield clips.

The *Hood* was an old ship, rusty and slow, built in 1916 and never properly refitted or armoured since.

She performed well in the North Atlantic and the Mediterranean, leading the force that destroyed the fleet of Vichy France at Mers-el-Kebir in 1940 (an action Mr Briggs found "revolting" though, as ordered, he tremblingly clipped up the white-and-red bunting that meant "Open fire"). But her plating groaned in heavy seas, and water sloshed almost continually over the afterdeck. "Briggo" learnt quickly the niceties of crapping without being washed away. But, boy as he was, he fretted about the ship. Well over his head, officers with "scrambled egg" on their chests did not worry until too late about the thinness of her deck-armour.

Roll out the barrel

On May 23rd 1941 the *Hood* hoisted her battle ensign. She had been shadowing the better-armoured *Bismarck*, a "jumped up" ship as Mr Briggs thought of her, for 30 days or so in the North Sea; now she was closing in. As the German ship fired her 15-inch shells, Mr Briggs, high on the compass platform, saw a vast sheet of flame blow up in front of him. Within minutes the *Hood* was listing at 40 degrees, and it was clear "she just wasn't coming back".

The deck was already awash. With a Burberry and a number-three suit over his life-vest, Mr Briggs struggled to undress, ripping off his gas-mask and his battle-helmet. When the water surged over him he quickly resigned himself to warm and cradling death. But almost at once he was propelled like "a champagne cork" back to the surface. A sudden air-pocket had saved him. He broke surface to see the bows of the *Hood* vertical in the sea. The sight recurred in his dreams ever after.

Some 1,415 men died when the *Hood* went down, perhaps the most demoralising disaster for Britain in the second world war. Three were saved. Mr Briggs clung to a life-raft, singing "Roll out the Barrel" to stay awake, until he was rescued after three hours by *HMS Electra*. Back on land he found himself a hero, plied with sweets and cigarettes and allowed the luxury of long baths with Lifebuoy soap. Yet when he reached his mother's house in Derby he collapsed in tears, "a gibbering, quivering young lad from the war returning".

He served as a signalman on other ships, retiring in 1973 with the rank of lieutenant, but the *Hood* never left him. An inquiry was held into the sinking; it found that a German shell had pierced the deck-armour and exploded in a magazine. Mr Briggs had his doubts. He blamed the unstable multiple rocket-launchers, a whim of Churchill's that the crew had always hated; he also blamed Admiral Holland, the commander-in-chief, for putting "our lovely old girl" in the van of the attack.

In 2001, almost 80, he visited the wreck site to release a plaque to his lost comrades. Far beneath the water the *Hood* lay broken in half. But her rudder was locked in obedience to the last signal Mr Briggs had seen hoisted, two blue-flag 2, a 20-degree port turn into the *Bismarck*'s guns.

Overview

Oct 23rd 2008
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China's economy is gradually slowing. GDP rose by 9% in the year to the third quarter, down from 10.1% in the year to the second quarter, and the weakest growth rate for five years. Consumer-price inflation fell further, from 4.9% to 4.6%, in September.

Canada's central bank lowered its benchmark interest rate by 0.25 percentage points, to 2.25%, on October 21st. The cut came two weeks after it had reduced rates by half a percentage point in concert with other central banks. The bank said that "some further monetary stimulus" would probably be needed to prevent medium-term inflation from falling below its 2% target.

The pound fell to a five-year low against the dollar, after the Bank of England's governor said that **Britain** was entering a recession. Fears of a deep downturn were raised by a gloomy survey from the Confederation of British Industry. Its measure of business optimism fell more in October than at any time since 1980.

The Reserve Bank of **India** cut its main interest rate by one percentage point, to 8%, to ward off a booming slowdown. It was the first cut since 2004.

Vietnam's central bank reduced its benchmark interest rate by one percentage point, to 13%.

Consumer-price inflation in **Australia** rose from 4.5% to 5.0% in the third quarter, the highest rate since 2001.

Output, prices and jobs

Oct 23rd 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.1 Q2	+2.8	+1.6	+0.6	-4.5 Sep	+4.9 Sep	+2.8	+4.5	6.1 Sep
Japan	+0.7 Q2	-3.0	+0.7	+0.6	-6.9 Aug	+2.1 Aug	-0.2	+1.8	4.2 Aug
China	+9.0 Q3	na	+9.8	+8.5	+11.4 Sep	+4.6 Sep	+6.2	+6.4	9.5 2007
Britain	+1.5 Q2	nil	+1.1	+0.1	-2.3 Aug	+5.2 Sep§	+1.8	+3.8	5.7 Aug††
Canada	+0.7 Q2	+0.3	+0.8	+1.4	-2.1 Jul	+3.5 Aug	+1.7	+2.8	6.1 Sep
Euro area	+1.4 Q2	-0.7	+1.2	+0.6	-0.7 Aug	+3.6 Sep	+2.1	+3.5	7.5 Aug
Austria	+2.2 Q2	+1.5	+2.1	+1.0	-0.4 Jul	+3.7 Sep	+2.1	+3.0	3.3 Aug
Belgium	+1.9 Q2	+0.9	+1.5	+0.9	+2.5 Jul	+5.5 Sep	+1.5	+4.5	11.2 Aug‡‡
France	+1.1 Q2	-1.3	+1.1	+0.7	-2.6 Aug	+3.0 Sep	+1.5	+3.2	8.0 Aug
Germany	+1.7 Q2	-2.0	+1.6	+0.6	+1.7 Aug	+2.9 Sep	+2.7	+2.9	7.6 Sep
Greece	+3.5 Q2	+3.1	+2.4	+1.5	-1.8 Aug	+4.6 Sep	+2.9	+4.6	7.0 Jul
Italy	-0.1 Q2	-1.1	+0.1	+0.3	-5.3 Aug	+3.8 Sep	+1.7	+3.6	6.8 Q2
Netherlands	+3.0 Q2	+0.5	+2.1	+1.0	-1.3 Aug	+3.1 Sep	+1.3	+2.5	3.8 Sep††
Spain	+1.8 Q2	+0.4	+1.4	+0.3	-11.2 Aug	+4.5 Sep	+2.7	+4.5	11.3 Aug
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.3	-2.6 Aug	+6.6 Sep	+2.8	+6.6	5.3 Sep
Denmark	+0.9 Q2	+1.6	+0.6	+0.8	-0.2 Aug	+4.2 Sep	+1.2	+3.3	1.6 Aug
Hungary	+2.0 Q2	+2.3	+2.0	+3.0	-5.9 Aug	+5.7 Sep	+6.4	+6.7	7.5 Aug††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	-5.7 Aug	+5.3 Sep	-0.3	+3.3	2.4 Jul***
Poland	+5.8 Q2	na	+5.4	+4.3	+7.0 Sep	+4.5 Sep	+2.3	+4.2	9.3 Aug‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+6.3 Sep	+16.1 Sep	+9.4	+14.0	5.3 Sep‡‡
Sweden	+0.7 Q2	-0.1	+1.3	+1.0	-1.8 Aug	+4.4 Sep	+2.2	+3.8	5.9 Sep‡‡
Switzerland	+2.4 Q2	+1.5	+2.0	+1.1	+6.1 Q2	+2.9 Sep	+0.7	+2.6	2.6 Sep
Turkey	+1.9 Q2	na	+3.7	+3.2	-4.0 Aug	+12.6 Sep	+7.1	+10.2	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.6	+2.3	+2.8 Q2	+5.0 Q3	+1.9	+4.2	4.3 Sep
Hong Kong	+4.2 Q2	-5.5	+3.8	+2.1	-4.2 Q2	+4.6 Aug	+1.6	+5.3	3.4 Sep††
India	+7.9 Q2	na	+7.3	+6.8	+1.3 Aug	+9.0 Aug	+7.3	+7.9	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+2.9 Aug	+11.0 Sep	+7.0	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+6.0	+5.6	+0.9 Aug	+8.5 Aug	+1.9	+5.4	3.5 Q2
Pakistan	+5.8 2008**	na	+6.0	+4.2	-3.9 Jul	+23.9 Sep	+8.4	+21.0	5.6 2007
Singapore	-0.5 Q3	-6.3	+4.0	+3.8	-12.2 Aug	+6.7 Sep	+2.7	+6.5	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.6	+3.3	+1.9 Aug	+5.1 Sep	+2.3	+4.9	3.1 Sep
Taiwan	+4.3 Q2	na	+4.3	+3.4	-1.4 Sep	+3.1 Sep	+3.1	+3.8	4.1 Sep
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+7.9 Aug	+6.0 Sep	+2.1	+6.4	1.2 Jun
Argentina	+7.5 Q2	+8.7	+6.0	+3.5	+4.2 Aug	+8.7 Sep	+8.6	+9.3	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+4.6	+3.4	+2.0 Aug	+6.3 Sep	+4.1	+6.0	7.6 Aug‡‡
Chile	+4.3 Q2	+7.4	+3.9	+3.3	-3.1 Aug	+9.2 Sep	+5.8	+8.7	8.2 Aug††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	-8.8 Aug	+7.6 Sep	+5.0	+6.7	11.1 Aug‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	-1.6 Aug	+5.5 Sep	+3.8	+4.8	4.3 Sep‡‡
Venezuela	+7.1 Q2	na	+5.4	+2.7	+3.6 Jul	+36.0 Sep	+15.3	+31.0	7.5 Q2‡‡
Egypt	+6.8 Q2	na	+7.1	+6.7	+6.8 Q2	+21.5 Sep	+9.3	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.2	+2.8	+9.7 Jul	+5.5 Sep	+1.4	+4.8	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+10.9 Aug	+5.0	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.4	+3.3	+0.4 Aug	+13.7 Aug	+6.7	+11.3	23.1 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-1.1 Q2	-3.2	-1.5	+0.4	-2.6 Aug	+10.5 Sep	+7.2	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.6	+1.1	-1.1 Aug	+4.7 Sep	+2.6	+4.0	6.5 Sep
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+14.0 Sep	+4.2	+12.0	1.3 Sep‡‡
Ireland	-0.8 Q2	-2.1	-0.5	-0.1	+4.2 Aug	+4.3 Sep	+4.6	+4.0	6.3 Sep
Latvia	+0.1 Q2	na	-0.4	-0.5	-11.1 Aug	+14.9 Sep	+11.4	+15.8	5.7 Jul
Lithuania	+5.2 Q2	+4.5	+5.1	+3.7	na	+11.1 Sep	+7.0	+10.8	4.7 Aug‡‡
Luxembourg	+2.8 Q2	+4.5	+2.8	+2.6	+11.9 Aug	+4.0 Sep	+2.1	+4.0	4.2 Aug‡‡
New Zealand	-0.3 Q2	-2.1	+0.4	+1.5	+2.4 Q2	+5.1 Q3	+1.8	+4.1	3.9 Q2
Peru	+8.9 Aug	na	+9.1	+6.5	+5.6 Aug	+6.2 Sep	+2.8	+5.7	8.6 Aug††
Philippines	+4.6 Q2	+8.4	+4.5	+3.9	+8.1 Jul	+11.9 Sep	+2.7	+9.7	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	-0.4 Aug	+3.1 Sep	+2.1	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.0	+5.2	+0.9 Aug	+5.4 Sep	+2.9	+4.4	7.5 Sep††
Slovenia	+5.5 Q2	na	+4.5	+3.5	-7.1 Aug	+5.5 Sep	+3.5	+6.0	6.4 Aug‡‡

*% change on previous quarter, annual rate. † *The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 5.0% in Sept. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Oct 23rd 2008
From The Economist print edition

The Economist commodity-price index

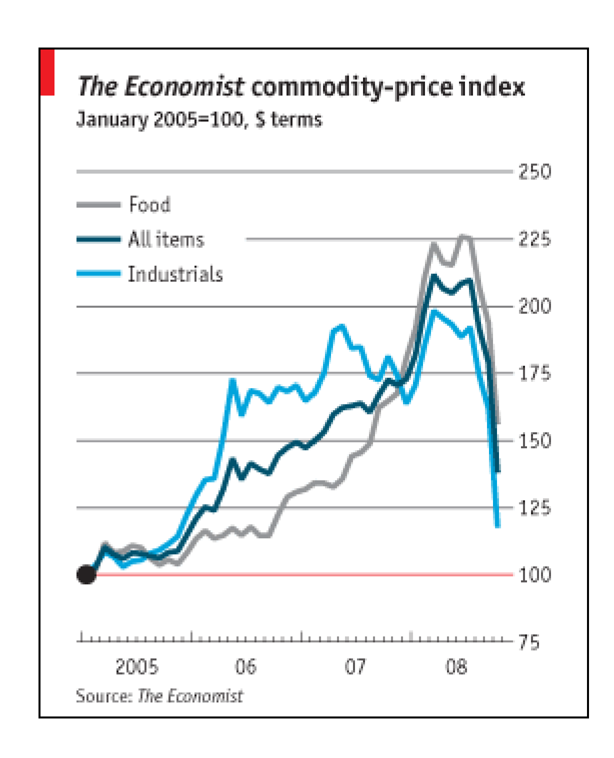
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	Oct 14th	Oct 21st*	% change on one month	% change on one year
Dollar index				
All items	184.8	172.4	-23.7	-20.3
Food	189.9	184.0	-20.8	-5.3
Industrials				
All	178.3	157.5	-27.7	-35.7
Nfa†	142.2	139.9	-23.2	-18.1
Metals	198.0	167.2	-29.7	-41.4
Sterling index				
All items	159.8	154.2	-16.5	-3.7
Euro index				
All items	125.4	120.9	-14.8	-13.9
Gold				
$ per oz	838.40	773.55	-14.2	+2.2
West Texas Intermediate				
$ per barrel	79.35	71.00	-34.4	-16.7

*Provisional †Non-food agriculturals.

The Economist commodity-price index

Oct 23rd 2008
From The Economist print edition



Impending recession and selling by speculators have snuffed out the boom in commodity prices. Our dollar all-items index, which excludes oil and precious metals, has plunged by 37% since the beginning of July. Metals have fared worst; prices have fallen by almost half since March. Indonesia is now cutting tin production and nickel mines in Canada are closing. Copper stocks in London Metal Exchange warehouses jumped by 62% in the third quarter. Food prices have also plunged. The world wheat harvest is forecast to be a record this season. America's agriculture department reckons that demand for maize as animal feed will fall and weaker petrol consumption will cut demand for biofuels.



Trade, exchange rates, budget balances and interest rates

Oct 23rd 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Oct 22nd	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	-848.0 Aug	-699.0 Q2	-4.7	-	-	-2.5	2.15	3.61
Japan	+77.9 Aug	+197.3 Aug	+3.9	98.9	114	-3.0	0.79	1.54
China	+258.0 Sep	+371.8 2007	+8.5	6.83	7.49	0.4	4.19	3.34
Britain	-188.9 Aug	-82.9 Q2	-3.1	0.61	0.49	-3.8	6.23	4.47
Canada	+50.8 Aug	+13.6 Q2	+1.1	1.25	0.97	0.2	1.90	3.68
Euro area	-26.4 Aug	-38.5 Jul	-0.4	0.77	0.70	-0.9	4.94	3.79
Austria	-0.1 Jul	+14.5 Q2	+2.6	0.77	0.70	-0.8	4.94	4.19
Belgium	+3.3 Jul	-9.8 Jun	+1.6	0.77	0.70	-0.6	5.00	4.29
France	-76.9 Aug	-54.2 Aug	-1.8	0.77	0.70	-2.9	4.94	4.03
Germany	+279.8 Aug	+269.3 Aug	+6.5	0.77	0.70	1.1	4.94	3.78
Greece	-67.2 Jul	-50.8 Aug	-14.0	0.77	0.70	-3.3	4.94	4.78
Italy	-15.4 Aug	-71.1 Aug	-2.5	0.77	0.70	-2.6	4.94	4.61
Netherlands	+60.1 Aug	+62.5 Q2	+6.2	0.77	0.70	0.7	4.94	4.09
Spain	-154.1 Jul	-165.2 Jul	-9.8	0.77	0.70	-1.6	4.94	4.30
Czech Republic	+6.4 Aug	-4.3 Aug	-2.8	19.8	19.1	-1.9	4.23	4.55
Denmark	+6.4 Aug	+5.9 Aug	+1.3	5.77	5.24	3.8	5.95	4.31
Hungary	+0.5 Aug	-8.8 Q2	-5.5	214	177	-3.8	9.00	11.14
Norway	+83.2 Sep	+78.1 Q2	+17.3	7.00	5.46	17.7	6.79	4.18
Poland	-22.2 Aug	-26.3 Aug	-4.9	2.93	2.57	-1.9	6.81	7.48
Russia	+200.3 Aug	+104.3 Q2	+6.2	26.9	24.9	4.5	11.00	8.99
Sweden	+18.7 Aug	+38.6 Q2	+7.6	7.78	6.49	2.4	3.40	3.55
Switzerland	+17.3 Sep	+60.2 Q2	+13.0	1.16	1.17	0.9	2.98	2.76
Turkey	-76.0 Aug	-48.7 Aug	-6.4	1.65	1.22	-1.8	20.08	10.39‡
Australia	-15.6 Aug	-61.1 Q2	-5.1	1.48	1.11	1.3	5.85	5.12
Hong Kong	-26.1 Sep	+27.5 Q2	+10.8	7.75	7.75	0.7	3.14	2.26
India	-100.3 Aug	-21.9 Q2	-2.9	49.3	39.6	-4.3	8.66	8.10
Indonesia	+19.0 Sep	+6.3 Q2	+2.8	9,900	9,178	-2.0	12.11	15.35‡
Malaysia	+41.0 Aug	+35.3 Q2	+14.4	3.55	3.37	-3.1	3.67	5.81‡
Pakistan	-22.5 Sep	-14.0 Q2	-7.2	81.4	60.7	-6.7	14.39	25.95‡
Singapore	+22.9 Sep	+32.8 Q2	+18.6	1.50	1.46	1.0	1.16	2.70
South Korea	-11.7 Sep	-7.1 Aug	-3.3	1,363	918	1.1	6.12	5.37
Taiwan	+6.9 Sep	+32.6 Q2	+4.6	33.0	32.6	-1.8	2.60	2.18
Thailand	+5.4 Aug	+7.8 Aug	+1.1	34.6	34.1	-2.9	3.85	3.99
Argentina	+13.2 Aug	+6.0 Q2	+3.1	3.22	3.18	0.7	17.13	na
Brazil	+28.8 Sep	-21.9 Aug	-1.6	2.37	1.80	-1.6	13.66	6.16‡
Chile	+16.1 Sep	+1.0 Q2	-0.5	645	505	6.5	9.36	5.34‡
Colombia	+1.8 Jul	-4.9 Q2	-2.6	2,340	2,022	-1.0	10.03	10.50‡
Mexico	-9.4 Aug	-5.3 Q2	-0.8	13.5	10.8	-0.1	7.58	10.45
Venezuela	+41.9 Q2	+37.8 Q2	+14.8	5.38	4.23§	1.6	17.00	6.55‡
Egypt	-23.4 Q2	+0.9 Q2	+0.2	5.59	5.52	-7.1	12.86	7.20‡
Israel	-13.1 Aug	+3.5 Q2	+0.9	3.86	4.04	-0.8	3.40	5.06
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.75	3.74	13.3	4.62	na
South Africa	-10.3 Aug	-22.5 Q2	-7.7	11.1	6.66	0.2	12.35	9.85
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	-4.3 Jul	-3.3 Aug	-11.8	12.1	11.0	-0.5	6.62	na
Finland	+11.9 Aug	+10.6 Aug	+3.8	0.77	0.70	4.5	4.98	4.23
Iceland	-0.9 Sep	-4.5 Q2	-14.6	117	61.3	2.0	12.51	na
Ireland	+38.2 Jul	-15.8 Q2	-3.5	0.77	0.70	-3.9	4.94	4.45
Latvia	-6.9 Aug	-5.5 Aug	-15.0	0.55	0.49	-1.5	9.80	na
Lithuania	-8.0 Aug	-6.8 Aug	-14.0	2.68	2.43	-0.7	6.96	na
Luxembourg	-6.9 Jul	+5.1 Q2	na	0.77	0.70	0.5	4.94	na
New Zealand	-3.2 Aug	-11.4 Q2	-7.1	1.68	1.33	0.3	6.85	5.91
Peru	+6.3 Aug	-1.5 Q2	-1.6	3.14	3.02	2.7	6.50	na
Philippines	-8.7 Jul	+4.3 Jun	+2.0	48.7	44.3	-0.9	5.25	na
Portugal	-32.9 Jul	-27.9 Jul	-9.0	0.77	0.70	-2.5	4.94	4.36
Slovakia	-0.9 Aug	-5.6 Jun	-5.6	23.6	23.4	-2.1	3.26	4.74
Slovenia	-4.5 Aug	-3.1 Jul	-6.6	0.77	0.70	0.4	4.94	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.



Markets

Oct 23rd 2008
From The Economist print edition

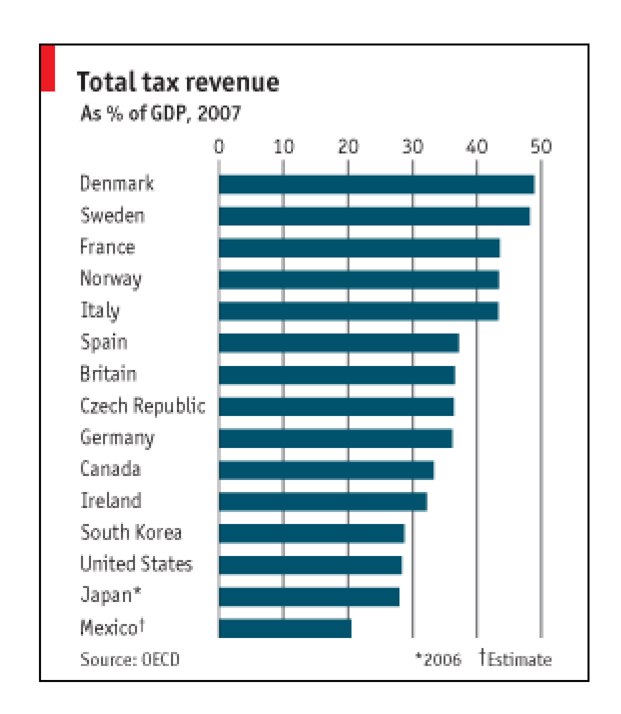
Markets

	Index	% change on		
			Dec 31st 2007	
	Oct 22nd	one week	in local currency	in $ terms
United States (DJIA)	8,519.2	-0.7	-35.8	-35.8
United States (S&P 500)	896.8	-1.2	-38.9	-38.9
United States (NAScomp)	1,615.8	-0.8	-39.1	-39.1
Japan (Nikkei 225)	8,674.7	-9.1	-43.3	-36.0
Japan (Topix)	889.2	-6.9	-39.7	-32.0
China (SSEA)	1,991.4	-4.9	-63.9	-61.5
China (SSEB, $ terms)	103.4	-7.1	-73.6	-71.8
Britain (FTSE 100)	4,040.9	-0.9	-37.4	-48.6
Canada (S&P TSX)	9,236.9	-0.9	-33.2	-47.3
Euro area (FTSE Euro 100)	751.1	-5.1	-45.4	-51.8
Euro area (DJ STOXX 50)	2,458.0	-4.7	-44.1	-50.7
Austria (ATX)	1,973.9	-13.1	-56.3	-61.4
Belgium (Bel 20)	1,968.6	-5.5	-52.3	-57.9
France (CAC 40)	3,298.2	-2.5	-41.3	-48.1
Germany (DAX)*	4,571.1	-6.0	-43.3	-50.0
Greece (Athex Comp)	2,025.9	-14.9	-60.9	-65.5
Italy (S&P/MIB)	21,093.0	-5.1	-45.3	-51.7
Netherlands (AEX)	255.1	-3.0	-50.5	-56.3
Spain (Madrid SE)	966.8	-7.4	-41.1	-48.0
Czech Republic (PX)	853.9	-14.5	-53.0	-56.9
Denmark (OMXCB)	262.1	-5.8	-41.6	-48.4
Hungary (BUX)	11,916.0	-17.7	-54.6	-63.3
Norway (OSEAX)	293.3	-0.2	-48.5	-60.1
Poland (WIG)	27,282.3	-12.0	-51.0	-58.8
Russia (RTS, $ terms)	665.8	-15.6	-68.2	-70.9
Sweden (Aff.Gen)	196.5	-1.8	-42.3	-52.1
Switzerland (SMI)	5,925.5	+0.2	-30.2	-31.9
Turkey (ISE)	25,624.3	-13.0	-53.9	-67.2
Australia (All Ord.)	4,120.1	-3.6	-35.8	-50.8
Hong Kong (Hang Seng)	14,266.6	-10.8	-48.7	-48.4
India (BSE)	10,169.9	-5.9	-49.9	-59.9
Indonesia (JSX)	1,440.1	-5.3	-47.6	-50.2
Malaysia (KLSE)	904.3	-4.8	-37.4	-41.6
Pakistan (KSE)	9,183.7	nil	-34.8	-50.6
Singapore (STI)	1,821.1	-11.6	-47.5	-49.6
South Korea (KOSPI)	1,134.6	-15.3	-40.2	-58.9
Taiwan (TWI)	4,862.6	-7.3	-42.8	-43.8
Thailand (SET)	465.2	-3.4	-45.8	-47.2
Argentina (MERV)	940.8	-20.7	-56.3	-57.2
Brazil (BVSP)	35,069.0	-4.8	-45.1	-58.7
Chile (IGPA)	11,498.8	-1.3	-18.3	-36.9
Colombia (IGBC)	7,284.8	-5.0	-31.9	-41.3
Mexico (IPC)	18,787.3	-11.1	-36.4	-48.5
Venezuela (IBC)	36,432.3	+0.2	-3.9	-61.6
Egypt (Case 30)	5,112.3	-14.4	-51.2	-51.8
Israel (TA-100)	685.8	-1.4	-40.6	-40.8
Saudi Arabia (Tadawul)	6,160.8	-10.2	-44.2	-44.2
South Africa (JSE AS)	20,288.6	-1.4	-29.9	-57.0
Europe (FTSEurofirst 300)	873.9	-3.3	-42.0	-48.8
World, dev'd (MSCI)	909.8	-4.3	-42.7	-42.7
Emerging markets (MSCI)	534.7	-14.2	-57.1	-57.1
World, all (MSCI)	224.1	-5.3	-44.4	-44.4
World bonds (Citigroup)	736.0	-0.6	+0.8	+0.8
EMBI+ (JPMorgan)	321.7	-11.0	-25.8	-25.8
Hedge funds (HFRX)	1,096.1	+0.5	-17.6	-17.6
Volatility, US (VIX)	69.7	69.3	22.5	(levels)
CDSs, Eur (iTRAXX)†	151.4	+14.2	+199.2	+164.1
CDSs, N Am (CDX)†	221.8	+6.6	+184.8	+184.8
Carbon trading (EU ETS) €	19.9	-13.1	-10.4	-20.9

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Total tax revenue

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Tax revenues have risen as a share of GDP across the OECD over the past 30 years. In 2007 Denmark's government collected nearly half its GDP as taxes, making it the most heavily taxed among all the rich countries. The Danes narrowly edged out Sweden, the previous year's most heavily taxed country. France, Norway and Italy also have tax revenues of more than 40% of GDP. At the other end of the spectrum, America and South Korea are relatively lightly taxed, with ratios of under 30%. However they are not as lightly taxed as Mexico, where the government's tax revenues are barely a fifth of GDP. In general Europe is the most heavily taxed region in the OECD and taxes are lowest in the Americas.